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IN THE

# Supreme Court of the United States

October Term, 1949

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# No.

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NELLIE IONE GRAY, EVLYN LEVISON, A. C. McLAUGHLIN, and the PHILLIPS PETROLEUM COMPANY,

Petitioners,

vs.

AMBROSE OLDLAND; CARRIE KNOWLES; ERNEST OLDLAND; GERALD OLDLAND; WALTER OLDLAND; CECILIA H. YOUNG, as sole Heir at Law of Leonard J. Young and as sole Legatee and Devisee under the last will and testament of said Leonard J. Young, deceased; THOMAS A. YOUNG; MABEL McGLINN DAIGNAULT; MARGARET McGLINN; ESTELLE CONNER WAIT; HENRY W. CONNER; RUTH CONNER WILLS; LEONARD McGLINN; IRVING A. WYNN; CARLYLE WYNN, JR.; CARLYLE WYNN, SR.; MARION P. McGLINN, a minor appearing by her next friend, Ernest Oldland; WILLIS SAXE MONTGOMERY III; MARCELLE MONTGOMERY ELLIS; E. C. PARSONS; M. K. ANDREW; WILLIAM K. PARSONS; ELIZABETH G. CARNEY; THOMAS F. CARNEY; MARIE LOUISE CROCKETT; WILLIAM CHARLES CARNEY; BETTY CARNEY, also known as Elizabeth Carney, and ERNESTINE CARNEY, Minors, appearing by their next friend, Elizabeth G. Carney; HARRIETT ROSE KIMBALL; JOHN WATSON CARD, as Executor and Devisee under the last will and testament of Maggie Moog, Deceased; BENNETT C. SHIDELER; ELIZABETH R. WELTON; CORDENIA C. MILLER; OLIVE O. JOHNSTON; LILLIAN STEVENSON; CHARLES W. BANTA; ANNA REES; AVIS NEAL ROEMER; JOE TRACHTA; JOE JUHAN; CHARLES J. PEARSALL; HATTIE P. JOCELYN; CLIFFORD R. PEARSALL; RICHARD PEARSALL; ALICE P. HEINDEL; MARY PEARSALL; RAYMOND PEARSALL; CLAIRE P. PLATTER; FRANCIS M. SHIDELER; BYRON H. SHIDELER; JOHN CHESTER SMITH, an infant, by his next friend, Joseph J. Shideler; ELEANOR HASKINS; ROBERT W. SHIDELER; WALTER M. SHIDELER; EDWARD T. WILLIAMS; THOMAS EDWARD WILLIAMS, an infant, by his next friend, Joseph J. Shideler; JOSEPH J. SHIDELER; ROSE MYRTLE RECTOR, as heir at law and administratrix of the estate of James William Rector, deceased; JAMES RICHARD RECTOR; RUBY RECTOR KIRBY; and LEONA RECTOR HINRICKS,

Respondents.

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## PETITION FOR WRIT OF CERTIORARI TO UNITED STATES COURT OF APPEALS, TENTH CIRCUIT

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## I. SUMMARY STATEMENT OF MATTER INVOLVED

Petitioners seek review of a judgment of the United States Court of Appeals for the Tenth Circuit, which reversed a judgment in petitioners' favor theretofore entered by the United States District Court for the District of Colorado. The decision and judgment of the Court of Appeals is final in that it leaves nothing to be done by the District Court except the ministerial act of entering judgment in accordance with the mandate of the Court of Appeals.

The judgment of the Court of Appeals constitutes the judicial rewriting of a private contract in such manner as to impose additional and heavy burdens upon the petitioner Phillips Petroleum Company without its consent either express or implied. Such a judgment constitutes abuse of the judicial process and amounts to a denial of due process of law and a deprivation of liberty (freedom to contract) in contravention of Article V of the Amendments to the Constitution of the United States.

This action originally was brought by respondents in the District Court of Rio Blanco County, Colorado, and was removed to the United States District Court for the District of Colorado. The removal was sustained on the theory that there was diversity of citizenship and a separable controversy insofar as the petitioner Phillips Petroleum Company is concerned (R. 616).

The claim asserted in this litigation by respondents is for recovery of oil royalties allegedly due them on account of production by Phillips Petroleum Company on public lands of the United States in the Rangely Oil Field, Rio Blanco County, Colorado. Respondents rely on provisions of an assignment contract executed in 1926 (R. 13-17) whereby the Oldland group (being the predecessors in

interest of respondents) conveyed a United States prospecting permit covering the lands in question to petitioner McLaughlin. This conveyance was based on a consideration of Fifteen Hundred Dollars ($1500.00) (R. 524). The present controversy centers around the provisions in that contract for the payment of royalty, which read (R. 14-15):

> "In the event of discovery being made upon said permit area of oil and/or gas in quantities deemed by Assignee to be sufficient to pay to pump or to otherwise secure and save the same, then Assignee shall apply for leases embracing said permit area *and Assignee shall have the right to designate the one-quarter of the permit area to be embraced in lease prescribing a flat Government royalty of 5%.*
>
> *That in the event of leases being issued to Assignee embracing respectively one-quarter and three-quarters of said permit area,* Assignee shall pay out of production secured thereon royalties due the Government as in said leases prescribed and shall pay to said Oldland Group *a royalty of 7½%* of the market value at the time produced of oil produced and saved on said lease *embracing one-quarter of the premit area in which a Government royalty of 5% is prescribed* and shall pay to the Oldland Group *a royalty of 4%* of the market value of the oil produced and saved on said lease *embracing three-quarters of the permit area in which a graduated Government royalty is prescribed.* For all gas produced and saved and sold off the premises by Assignee, Assignee shall pay said Oldland Group 7½% of all moneys received from the sale of such gas." (Emphasis added)

The above quoted contractual provisions were proper and enforceable under the Mineral Leasing Act of 1920 which was in effect at the time of the execution of the contract (See Section 14, Act of February 25, 1920, 41

Stat. 442). The Act of August 21, 1935, (49 Stat. 676) amended the 1920 Act so as to (1) eliminate prospecting permits and (2) eliminate the provisions for separate leases on one-quarter and three-quarters, respectively, of the permit area and (3) authorized a graduated royalty scale with a prescribed minimum of 12½%, thereby eliminating the old flat 5% royalty to the Government on one-quarter of the acreage. Thus, the royalty payment provisions of the 1926 contract were inapplicable and impossible of performance under the 1935 Act.

McLaughlin, as Assignee of the Oldland Group, did not produce any oil, but kept the prospecting permit alive until it terminated by operation of the 1935 Act on December 31, 1938 (R. 299, 300, 447). As permitted by the 1935 Act, McLaughlin applied for an exchange lease (R. 448, 450, 455), at the time of expiration of the prospecting permit. In acting on such application, the Commissioner of the then General Land Office ordered that notice be sent to the original permittees that, unless a contrary statement signed by the contracting parties be furnished, the 1926 contract would be considered as an assignment of the prospecting permit "in its entirety to A. C. McLaughlin" and that, if McLaughlin showed satisfactory qualifications, action would be taken to approve the assignment to the end that McLaughlin would be entitled to an exchange lease in his name (R. 450). This notice actually was forwarded to the attorney-in-fact for the Oldland Group who, although he was then dead, was the person shown by the records of the Interior Department as the proper person to notify, and this notice was in fact received by at least one member of the Oldland Group and by the heir of the attorney-in-fact who was also a member of that group (R. 449-452). There is no showing of any kind that any member of the Oldland Group, or anyone on behalf of such a member of said group, took action pursuant to the notice received from the Commissioner or any other action to oppose the approval of the assignment to Mc-

Laughlin of the permit in its entirety and the issuance of the exchange lease to McLaughlin alone.

As a result of these circumstances, an exchange lease for a period of five years, dated December 31, 1938, was issued to McLaughlin alone (R. 448, 450, 455). He assigned this lease to the petitioners Levison and Gray, who paid the required rentals but did not drill (R. 313). Upon the expiration of that lease, Levison and Gray secured a new lease from the United States under the Act of July 29, 1942 (56 Stat. 726) (R. 484). This Act provided that "the record title holder shall be entitled to a preference right over others to a new lease for the same land." This lease was assigned to petitioner Phillips Petroleum Company which thereafter drilled upon the land and secured production (R. 593, 307). Phillips declined to recognize any claim of the respondents to royalty (R. 590-591), after which this litigation was instituted.

The trial Court held that Acts of Congress subsequent to the 1926 contract abrogated the royalty obligations of that contract, and that such contract did not make McLaughlin or his successors trustees for the benefit of the Oldland Group (R. 202). The final memorandum of the trial judge appears at record pages 195-197, and his findings of facts and conclusions of law are at record pages 197-203.

The Court of Appeals reversed the District Court and held that the 1926 contract did create a trust under which Phillips Petroleum Company, as successor trustee, was obligated to pay royalty to the respondents in the amount of four per cent (4%) on oil produced and seven and one-half per cent (7½%) on gas produced. Recognizing that the royalty provisions of the 1926 contract were incapable of performance, the Court of Appeals said that, in an equitable action such as this, the Court had power to grant such relief as was found appropriate (R.620). In arriving

at its conclusion, the Court of Appeals directed attention to an affidavit executed by McLaughlin in connection with his application for an exchange lease (R. 450-451) in which he stated that he was obligated to pay to the original permittees a royalty of four per cent (4%) on oil produced (R. 621). This statement by McLaughlin was in conflict with the terms of the 1926 contract and its effect, at the very most, was that of an offer which admittedly was never accepted and which has never been recognized by Phillips Petroleum Company as binding on it. The Court of Appeals also directed attention to a letter written by a representative of Phillips Petroleum Company in connection with the negotiations conducted by that company with Levison and Gray to secure an assignment of the current lease (R. 621). The statement was to the effect that the writer thought there was an outstanding royalty of four per cent (4%) in favor of the original permittees. It represented the efforts of a landman, not a lawyer, to require, in good business practice, the other parties to negotiations to remove any possible cloud on title (R. 274-275, 322). The statement was not written to nor for the benefit of respondents, and is not binding at their instance.

Under the decision of the Court of Appeals, Phillips Petroleum Company is required to pay substantially more royalty than would have been the case if dual leases had been issued as contemplated by the 1926 contract. Under that contract, on the one-quarter of the acreage on which the then law required payment of a five per cent (5%) royalty to the Government, the Assignee was required to pay to Oldland Group a royalty of seven and one-half per cent (7½%). Thus the total royalty to the Government and the Oldland Group was twelve and one-half per cent (12½%). Under the present lease and decision of the Court of Appeals the combined minimum possible royalty on oil produced is sixteen per cent (16%). This is made up of twelve and one-half per cent (12½%) payable to the United States and four per cent (4%) of the balance (said bal-

ance being 87½%), which is the same as three and one-half per cent (3½%) of total production, payable to the respondents. This method of computation appears to be required by the following language of the Court of Appeals appearing at page 621 of the record: "* * * the appellants are entitled to an overriding royalty of 4 per cent of the oil and 7½ per cent of the gas produced, saved and sold from the leasehold estate, free and clear of cost, subject only to the Government royalty." Actually, at the time of trial production was at such rate that, under the sliding scale royalty schedule of the Government lease, Government royalty was seventeen per cent (17%) (R. 461, 485, 306). This leaves a balance of eighty-three per cent (83%), representing the working interesting oil, after deducting Government royalty. The four per cent (4%) of this working interest oil to which respondents would be entitled is the equivalent of three and thirty-two one-hundredths per cent (3.32%) of the whole oil production. Consequently, the total combined royalty as of the time of trial is in fact twenty and thirty-two one-hundredths per cent (20.32%) as opposed to a maximum royalty of twelve and one-half per cent (12½%) on one-quarter of the acreage under the 1926 contract. In dollars, this means Two Hundred Fifteen Dollars and Five Cents ($215.05) *per day* payable by the oil producer in excess of the amount which would have been paid by it under the 1926 contract.[1] The imposition of such

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1. This computation is made as follows: The estimated average production per well per day at the time of trial was 100 barrels (R. 306). The estimated average price of oil in the Rangely Field at the time of trial was $2.50 per barrel (R. 307). This amounts to a total value of production per day per well of $250.00. The total area of the lease under litigation is 1760 acres (R. 3, 389, 458, 485) of which 440 acres would have comprised the one-quarter of the permit area carrying a flat 5% royalty to the Government under the old system and under the 1926 contract. The location of that 440 acres, to carry the 5% Government royalty, was subject to selection by the applicant and was, of course, the proven or most nearly proven area of the permit. In this instance the pattern is to drill one well to 40 acres (R. 307) and, since 16 wells had been drilled at the time of trial (R.307), it is clear that we may validly assume that there were and are 11 wells producing from the area which, under the old permit system and the 1926 contract, would have carried a flat 5% royalty to the Government. The value of the total production of these 11 wells per day would be $2,750.00. Under the old system and the 1926 contract, the combined royalty required to be paid by the producer (12½%) would have amounted to $343.75 per day. Under the decision of the Court of Appeals the combined royalties at the rates applicable to the production (total of 20.32%) requires the oil producer to pay $558.80 per day. Thus the effect of the decision of the Court of Appeals is to impose an additional burden on the oil producer of the difference between these two figures, or $215.05 per day.

additional burden was pointed out by the petitioners at the earliest possible time, that is, in their petition for a rehearing in the Court of Appeals.

## II. JURISDICTION

The petitioners say that this Court has jurisdiction to review this cause on writ of certiorari for the following reasons:

1. This petition for writ of certiorari is filed under the express provisions of the Act of June 25, 1948, c. 646, 62 Stat. 928 (28 U. S. C. Sec. 1254) which provides that cases in the courts of appeal may be reviewed by the Supreme Court by writ of certiorari either before or after rendition of judgment or decree. In this instance judgment has been rendered by the Court of Appeals and nothing remains for the Trial Court to do except to enter judgment pursuant to the mandate. Clearly, then, this is judgment subject to review on writ of certiorari. See *Land vs. Dollar,* 330 U. S. 731; *United States vs. General Motors Corporation,* 323 U. S. 373; Cf. *Dickinson vs. Petroleum Conversion Corporation,* decided January 16, 1950, 70 S. Ct. (advance sheets) 322; *Urie vs. Thompson,* 337 U. S. 163.

2. The decision of the Court of Appeals rewrites a contract which became impossible of performances by intervening changes in law. Such action imposes upon the petitioners burdens far more onerous than those imposed by the original contract. These circumstances create substantial grounds for review of the decision by this Court under its supervisory powers because:

A. The decision constitutes an important departure from the accepted and usual course of judicial proceedings.

B. It is contrary to the decision of another circuit.

C. It is contrary to decisions of this court.

D. It is contrary to local decisions of the state court on an important question of local law.

E. It misapprehends the effect of Acts of Congress.

F. It results in an overriding royalty obligation on production from Federal land in excess of that permitted by valid Federal regulations.

G. It deprives petitioners of property and of liberty (freedom to contract) without due process of law and in violation of the Fifth Amendment.

3. The question is substantial because it involves an abuse of the judicial function and imposes an increased burden, over and above the amount of the original contract, of approximately Two Hundred Dollars ($200.00) *per day,* and because it involved a principle of importance in the application of overriding royalties in the oil industry.

4. The questions sought to be reviewed were raised by the pleadings (complaint, R. 10-11; answers, R. 41, 42, 43, 57-58, 59, 60-61, 64, 66, 67-68) except for the question centering around the point that the decision imposes a large burden, substantially in excess of that which would have existed under the 1926 contract as written, which point was first raised on petition for rehearing in the Court of Appeals (R. 631), since the grounds therefor came into existance only by the decision of that Court.

5. Judgment was entered by the Court of Appeals on January 5, 1950 (R. 622). Rehearing was denied, after timely and appropriate petition therefor, on February 3, 1950 (R. 633).

## III. QUESTIONS PRESENTED

1. Does the decision of the Court of Appeals rewrite the 1926 contract in such manner as to alter the agreement of the parties and thereby constitute a denial of due process of law in violation of the Fifth Amendment and does

that decision deprive petitioners, or any of them, of liberty, in the form of freedom to contract, in contravention of the Fifth Amendment?

2. Pursuant to the accepted and established common law created by decisions of this Court, United States Courts of Appeals and the Supreme Court of Colorado, may the courts rewrite the provisions of the 1926 contract to make them operative under the altered conditions resulting from the changes in statutory law, particularly when such rewriting imposes upon the oil producer burdens substantially greater than those imposed pursuant to the agreement of the parties and when such rewriting creates a royalty obligation on production from Federal lands in excess of that permitted by valid Federal regulations?

3. Does the 1926 contract, which was admittedly proper under the terms of the Mineral Leasing Act of 1920, create a trust relationship which is binding on the producer of oil under a lease issued by the United States under the 1942 Act, which precludes performance of the royalty payment provisions of said contract?

4. Are the respondents precluded from any recovery by their own acts and laches?

## IV. REASONS RELIED ON FOR ALLOWANCE OF WRIT OF CERTIORARI

The reasons relied on for the allowance of this writ of certiorari are as follows:

1. By judicially rewriting the 1926 contract and applying it to current facts, and by thus imposing substantially heavier burdens on Phillips Petroleum Company, the Court of Appeals has abused the judicial process in such manner as to require the exercise by this Court of its supervisory powers because of the importance of the principles in-

volved, not only to this case, but generally in the judicial process. This is so for the following reasons:

(a) The decision of the Court of Appeals is contrary to decisions of this Court to the effect that a court may not make a contract for litigating parties, but may merely construe such contracts as written. *Riddle & Co. v. Mandeville and Jamesson,* 5 Cranch 322, 328, 3 L. Ed. 114, 116; *Hunt v. Administrators,* 1 Pet. 1, 14, 7 L. Ed. 1, 33; *Ingle v. Jones,* 2 Wall. 1, 17 L. Ed. 762, 764; *Maryland v. B. & O. R. R. Co.,* 22 Wall. 105, 22 L. Ed. 713, 714; *Baltzer v. Railroad Co.,* 115 U. S. 634; *City of New Orleans v. New Orleans Water Works Co.,* 142 U. S. 79.

(b) The decision of the Court of Appeals is contrary to similar decisions regarding the right of a court to rewrite a contract, in various Federal judicial circuits and particularly to *Cummings v. Clark,* 2 F. (2d) 442, decided by the Third Circuit, wherein the court held that it could not rewrite a contract which had been made impossible of performance by intervening statutes, a situation closely analagous to that here.

(c) The Court of Appeals has decided an important question of local law in a manner in conflict with applicable local decisions regarding the right of a court, even in an equity case, to rewrite a contract. *Buchalter v. Myers,* 85 Colo. 419, 436, 276 Pac. 972; *Kansas City Co. v. Pettit,* 99 Colo. 268, 270, 61 P. (2d) 1027; *Brennan v. Monson,* 97 Colo. 448, 453, 50 P. (2d) 534; *Gertner v. Limon National Bank,* 82 Colo. 13, 41 257 Pac. 247; *Sunset Oil Co. v. Whistleman,* 77 Colo. 570, 572, 237 Pac. 1116.

(d) This departure from the accepted and usual course of judicial procedure is a usurpation of power by the court which does violence to the established rules and principles of jurisprudence and therefore is

a taking of property without due process of law in violation of Article V of the Amendments to the Constitution of the United States.

(1) The fifth Amendment is a restraint upon judicial powers as well as legislative or executive powers. *Hovey v. Elliott,* 167 U. S. 409; *Den v. Hoboken, L & I Co.,* 18 How. 272.

(2) The phrase "due process of law" includes a course of legal procedure according to the principles established in our system of jurisprudence. *Pennoyer c. Neff,* 95 U. S. 714, 733; *Endicott-Johnson Corporation v. Smith,* 266 U. S. 285, 288.

(3) In determining due process of law regard must be had to the practice at common law. *Twining v. New Jersey,* 211 U. S. 78, 100; *Crane v. Hahlo,* 258 U. S. 142, 147.

(e) The departure from the accepted and usual course of judicial procedure is so substantial as to deprive Phillips Petroleum Company of liberty to contract in violation of Article V of the Amendments to the Constitution of the United States.

(1) Freedom to enter into and carry out contracts in respect of property and private affairs is a matter of great public concern and not lightly to be impaired. *Highland v. Russell, etc. Co.,* 279 U. S. 253, 261; *Steele v. Drummond,* 275 U. S. 199, 205.

(2) That right is protected by the due process clause. *Allgeyer v. Louisiana,* 165 U. S. 578, 591; *Highland v. Russell etc. Co., supra.*

2. The 1926 contract did not create any trust relationship binding upon the producer of the oil.

(a) The decision of the Court of Appeals is directly contrary to a decision of the Fifth Circuit in the case of *Gordon v. Empire Gas and Fuel Co.,* 63

F. (2d) 487, cert. denied 289 U. S. 751, wherein it was held on facts bearing direct similarity to those in this case, that there is no fiduciary relationship in the assignment of a lease providing for the payment of overriding royalties wherein there is no provision making such overriding royalty provisions applicable to renewal or extension leases.

(b) The decision of the Court of Appeals departs from and tends to alter the course of judicial decision on a matter often litigated and of importance to the oil industry regarding the applicability of overriding royalties to new leases subsequently issued. Summers, Oil and Gas, Permanent Edition, Volume 2, Section 554, Page 320 and the cases therein cited.

(c) The royalty provisions of the 1926 contract merely constitute a promise to pay royalty on conditions expressly stated. The indicia of a trust are completely lacking.

(d) Even if a trust were created originally, it became impossible of performance and inoperative by reason of change in law.

(e) Whether or not a trust was created originally by the 1926 contract, it does not continue since that contract did not by its terms apply, nor is there any expression of intention to apply to extension, exchange, or renewal leases and, hence, it could not apply to production under a new lease obtained eighteen years later under a new and different statute.

(f) There is admittedly no privity of contract between Phillips Petroleum Company and the respondents and there can be no privity of estate because Phillips Petroleum Company holds under the 1942 Act and, pursuant thereto, holds a "new" lease.

3. Royalty is payable under the terms of the 1926 contract only upon the happening of a condition precedent,

the execution by the United States of dual leases, one of which carries a royalty to the Government of a flat five per cent (5%). That condition has never occurred and, by reason of change in law, can never occur.

4. The decision of the Court of Appeals creates a situation prohibited by valid Federal regulation. Section 192.83, 43 C. F. R. prohibits, and at all times pertinent has prohibited, the creation of overriding royalty obligations aggregating in excess of five per cent (5%) except in certain conditions not met here. The Court of Appeals has prescribed a royalty of seven and one-half per cent (7½%) on gas, which alone is violative of said regulation. The decision also requires payment of four per cent (4%) overriding royalty on oil which, when combined with the two and one-half per cent (2½%) to which Levison and Gray are entitled under already approved contract (R. 486-487), aggregates an amount in excess of that permitted by the regulation.

## VI. CONCLUSION

WHEREFORE, because of the importance of the questions involved and for the reasons hereinabove stated your petitioners respectfully pray that a writ of certiorari be issued out of and under the seal of this Court directed to the United States Court of Appeals, Tenth Circuit, commanding that court to secure and send to this Court a full and complete transcript of the record and proceedings of the court in the case of your petitioners which was therein entitled Ambrose Oldland, et. al., Appellants, vs. Nellie Ione Gray, Evlyn Levison, A. C. McLaughlin, and Phillips Petroleum Company, Appellees, No. 3907, to the end that said cause may be reviewed and determined by this Court as provided by the Act of June 25, 1948, c. 646, 62 Stat. 928, and the rules of this Court and that your petitioners have such other and further relief or remedy in the premises as this Court may deem appropriate and in conformity

with the provisions of said statute and the rules of this Court and that the judgment of the Court of Appeals, Tenth Circuit, be reversed.

Respectfully submitted,

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## BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

### OPINIONS OF COURTS BELOW

The opinion of the Court of Appeals is not as yet officially reported. It is found in the record at pp. 611-621. The opinion of the district court is not reported. The memorandum of the trial judge is found at R. 195-197 and his findings of fact and conclusions of law are at R. 197-203.

### JURISDICTION

Jurisdiction is invoked under the Act of June 25, 1948, c. 646, 62 Stat. 928, 28 USC sec. 1254 which provides that cases in the courts of appeal may be reviewed by the Supreme Court by writ of certiorari either before or after rendition of judgment or decree. The grounds for certiorari are that the petitioners have been deprived of property and liberty in violation of the Fifth Amendment; that the decision of the Court of Appeals is contrary to decisions of this Court, decisions of other courts of appeal, and decisions of the Supreme Court of Colorado in which state this controversy arose; and that the Court of Appeals erroneously held that a 1926 contract created a trust in favor of the respondents.

### STATMENT OF THE CASE

The claim asserted by the respondents (plaintiffs in the trial court) is for the recovery of oil royalties allegedly due to the respondents on account of oil produced on certain federal public lands in the Rangely Oil Field, Rio Blanco County, Colorado. Respondents rely on provisions of a 1926 assignment contract (R. 13-17) whereby the Oldland Group (respondents predecessors) conveyed a United States prospecting permit issued under Section 13 of the Mineral Leasing Act of February 25, 1920, (41 Stat. 437) to petitioner McLaughlin. This conveyance was based upon a consideration of $1,500.00 and purported to call

for certain royalties out of production. McLaughlin did not produce any oil (R. 299, 300). The prospecting permit terminated by operation of the applicable federal statute on December 31, 1938 (R. 447).

Proceeding under the Act of August 21, 1935, 49 Stat. 676, McLaughlin applied for and secured an exchange lease dated December 31, 1938, covering a period of five years (R. 448, 450, 455, 458). In acting upon McLaughlin's application for an exchange lease the Commissioner of the General Land Office required notice to be sent to the original permittees (the Oldland group) that, unless a contrary statement signed by the contracting parties was furnished, the 1926 contract would be considered as an assignment of the prospecting permit *in its entirety* to McLaughlin and that if McLaughlin showed the necessary qualifications he would be entitled to an exchange lease in his name (R. 450). There is evidence of the receipt of such notice (R. 449-452). No member of the Oldland Group took any action pursuant to the notice. In connection with his application McLaughlin filed an affidavit in which he stated that he was obligated to pay to the original permittees a royalty of 4% on the oil produced (R. 450-451).

He assigned this lease to the petitioners Levison and Gray, who paid the required rentals but did not produce any oil (R. 313). Upon the expiration of that lease, Levison and Gray secured a new lease from the United States under the Act of July 29, 1942, 56 Stat. 726 (R. 484). This lease in turn was assigned to petitioner Phillip Petroleum Company and production was secured under it (R. 306, 307).

The rights of the respondents, if any they have, are predicated upon the provisions in the 1926 contract for the payment of royalty. That contract appears in the Record at pp. 13-16. The predecessors of the respondents are there designated as the Oldland Group and the assignee is the petitioner McLaughlin. The contract provided that, upon

the discovery of oil in quantities deemed by the assignee to be sufficient to save, the Assignee shall apply for leases and shall have the right to designate the one-quarter of the permit area to be included in a lease carrying a flat government royalty of 5% (R. 14), pursuant to the provisions of the then existing Federal statutes. The contract then states that in the event of leases being issued to the Assignee embracing one-quarter and three-quarters of the permit area, the Assignee shall pay out of production a royalty of 7½% on the oil produced from that one-quarter of the area carrying a government royalty of 5% and shall pay out of production a royalty of 4% on the oil produced from the three-quarters of the area carrying a graduated government royalty (R. 15).

The district court held that various acts of Congress subsequent to the 1926 contract, in abrogating the dual lease system for one-quarter and three quarters of the permit area and in abrogating all provisions permitting payment of a royalty of 5% to the Government (or any royalty less than 12½%), also abrogated the royalty obligations of that contract and that such contract did not make McLaughlin, or any of his successors, trustee for the benefit of the respondents (R. 202). The final memorandum of the district judge appears at R. 195-197 and his findings of fact and conclusions of law are at R. 197-203.

The Court of Appeals reversed the district court (R. 622) and held that a trust relationship was created for the benefit of the respondents (R. 618); that the intervening legislation does not prevent an equitable solution; and that "in equity and good conscience the appellants (respondents) are entitled to an overriding royalty of 4 per cent of the oil and 7½% of the gas" (R. 621).

The decision of the Court of Appeals increases the burden and obligation on the petitioners. Under the 1926 contract the maximum royalty on one-fourth of the acreage

was 12½% (5% to the United States and 7½% to the Oldland Group). Under the decision of the Court of Appeals, the oil producer must pay a minimum royalty of 12½% to the United States and in addition must pay a royalty to the respondents. With production at the rate existing at the time of trial and with the price of oil then prevailing, the additional payment required of petitioner Phillips Petroleum Company, as heretofore pointed out, exceeds $200.00 *per day.*

## SPECIFICATION OF ERRORS

1. The decision of the Court of Appeals rewrites the contract of 1926 and thereby deprives petitioners of property without due process of law in violation of the Fifth Amendment.

2. The decision of the Court of Appeals deprives the petitioners of liberty (freedom to contract) without due process of law in violation of the Fifth Amendment.

3. The decision of the Court of Appeals is contrary to applicable decisions of the United States Supreme Court holding that:

(a) A court may not make a contract for the parties;

(b) The due process clause of the Fifth Amendment is binding on the judicial department of the government;

(c) Contract provisions producing results at variance with subsequent legislation may not be permitted to operate.

4. The decision of the Court of Appeals is contrary to decision of other courts of appeal holding that:

(a) A court may not make a contract for the parties;

(b) A contract, the performance of which is prevented by a subsequently enacted law, cannot be enforced;

(c) An assignee of an oil and gas lease is not bound to pay a royalty reserved in such assignment out of production under an extension or renewal lease when the assignment does not make the royalty provision applicable to such extension or renewal leases.

5. The decision of the Court of Appeals is contrary to decisions of the Supreme Court of the State of Colorado holding that a Court may not make a contract for the parties.

6. The Court of Appeals erroneously held that a trust relationship existed by reason of the 1926 contract.

7. The decision of the court of Appeals does violence to valid Federal regulations limiting the royalty payable under United States oil and gas leases.

8. The Court of Appeals erred in not holding that the claims of the respondents were barred by their laches.

## SUMMARY OF THE ARGUMENT

I. The decision of the Court of Appeals violates the Fifth Amendment to the United States constitution in that:

(a) It makes a new contract for the parties and imposes on the petitioners burdens substantially greater than would otherwise exist;

(b) In so doing the Court of Appeals has usurped a power not present in our jurisprudence and hence has deprived the petitioners of property without due process of law;

(c) The Court of Appeals has deprived the parties of the freedom to contract which is a liberty protected by the Fifth Amendment.

II. The Court of Appeals erroneously held that a trust relationship existed among the parties in that:

(a) The rights of the respondents are completely dependent upon the 1926 assignment contract, and

(b) That contract created a debt rather than a trust;

(c) That contract clearly does not apply to extension or renewal leases such as that under which production is obtained;

(d) The condition precedent, which under the 1926 contract must be met before royalties are payable, has never occurred;

(e) The royalty payment provisions of the 1926 contract are now impossible of performance because of changes of law;

(f) The royalty provisions of the 1926 contract do not attach to production from the existing lease under the 1942 act;

(g) There is a violation of valid Federal regulations; and

(h) The claims of the respondents are barred by their laches.

## I.

## BY IMPOSING UPON THE PETITIONERS OBLIGATIONS SUBSTANTIALLY MORE ONEROUS THAN THOSE IMPOSED BY THE WRITTEN CONTRACT UNDER WHICH THE RESPONDENTS CLAIM, THE COURT OF APPEALS HAS EXCEEDED ITS AUTHORITY IN VIOLATION OF THE FIFTH AMENDMENT.

### 1. The Court of Appeals Has Changed the Royalty Provisions of the 1926 Contract So as to Increase the Burden upon the Lessee.

The 1926 assignment contract which is the sole basis for the claim of the respondents provides in clear and un-

ambiguous language for a royalty to the assignors amounting to 7½% on the one-fourth of the acreage carrying a 5% government royalty and 4% on the three-fourths of the acreage carrying a minimum 12½% government royalty.

The decision of the Court of Appeals, recognizing that these provisions were impossible of performance after the passage of the 1935 act (act of August 21, 1935, 49 Stat. 676) which eliminated dual leases and required a minimum 12½% royalty to the government, states (R. 621) that the respondents "are entitled to an overriding royalty of 4 per cent of the oil and 7½% of the gas produced, saved and sold from the leasehold estate, free and clear of cost, subject, only to the Government royalty."

The result is that petitioner Phillips Petroleum Company, as the producer of oil from the premises, is required to pay a higher combined royalty on one-fourth of the acreage than it would have been required to pay under the 1926 contract. This is obvious because under the 1926 contract the *maximum* royalty on one-fourth of the acreage would have been 12½% (made up of 5% to the government and 7½% to the respondents). Under the Court of Appeals decision the *minimum* royalty on this one-fourth of the acreage is 16% (made up of 12½% to the Government and 3½% to the respondents). We have heretofore pointed out that in the circumstances reflected by the record, the increase requires a payment by the oil producer of approximately $200.00 more *per day* than is required under the contract.

**2. The Court of Appeals Has No Authority to Rewrite the Contract.**

It is elementary that courts are not authorized to make contracts for the parties but must construe them as written (*Ingle v. Jones,* 2 Wall. 1, 17 L. Ed. 762, 764; *Maryland v. B. & O. RR Co.,* 22 Wall. 105, 22 L. Ed. 713, 714;

*City of New Orleans v. New Orleans Water Works Co.*, 142 US 79, 12 S. Ct. 142, 147; *Green County v. Quinlan*, 211 US 582, 29 S. Ct. 162, 168).

The rule applies in equity cases. We quote from *Hunt v. Adm'rs of Rousmaniere*, 1 Pet. 1, 14, 7 L. Ed. 1, 33):

> "Equity may compel parties to perform their agreements, when fairly entered into, according to their terms; but it has no power to make agreements for parties, and then compel them to execute the same. The former is a legitimate branch of its jurisdiction, and in its exercise is highly beneficial to society. The latter is without its authority, and the exercise of it would be not only an usurpation of power, but would be highly mischievous in its consequences."

The following statement of Chief Justice Marshall in 1809 is pertinent *(Riddle & Co. v. Mandeville and Jamesson*, 5 Cranch 322, 328, 3 L. Ed. 114, 116):

> "If as was stated by the counsel for the defendants, the question is, whether a court of chancery would create contracts into which individuals had never entered, and decree the payment of money from persons who had never undertaken to pay it, the time of this court has been very much misapplied indeed in attending to the laborious discussion of this cause. The court would, at once, have disclaimed such a power, and have terminated so extraordinary a controversy."

In *Baltzer v. Raleigh & Augusta R. Co.*, 115 US 634, 6 S. Ct. 216, 223, this Court tersely stated that:

> "Courts of equity may compel parties to execute their agreements, but have no power to make agreements for them."

The local law in Colorado is in conformity with the principles so announced by this Court. In *Buchalter v.*

*Myers,* 85 Colo. 419, 436, 276 Pac. 972, the Supreme Court of Colorado said in an equity case:

> "Courts should not make new contracts for parties. It would result in filching the property or property rights from one man and donating them to another."

To the same effect are *Kansas City Co. v. Pettit,* 99 Colo. 268, 270, 61 P. (2d) 1027; *Brennan v. Monson,* 97 Colo. 448, 453, 50 P. (2d) 534; *Gertner v. Limon National Bank,* 82 Colo. 13, 41, 257 Pac. 247; *Sunset Oil Co. v. Whistleman,* 77 Colo. 570, 572, 237 Pac. 1116.

Numerous decisions of United States Courts of Appeal recognize the principle that a court may not make a contract for the parties. Typical of such decisions are *Shell Oil Co. v. Manley Oil Corp.* (7th Cir. 1942) 124 F. (2d) 714, 715; *Watson Bros. Trans. Co. v. Jaffa,* (8th Cir. 1944) 143 F. (2d) 340, 347; *Transcontinental & Western Air v. Parker,* (8th Cir. 1944) 144 F. (2d) 735, 736; *Adkins v. Adkins,* (7th Cir. 1945) 152 F. (2d) 489; *Pure Oil Co. v. Petrolite Corp.* (5th Cir. 1947) 158 F. (2d) 503, 505.

The decision in this case is in direct conflict with, or in disregard of, these many decisions of the United States Supreme Court, of other Federal circuits, and of the Supreme Court of Colorado.

**3. The Action of the Court of Appeals in Rewriting the Contract is a Taking of Property Without Due Process of Law.**

Under the authorities above cited it is a usurpation of power for a court to make an agreement for parties. This was likewise the rule under the English common law (see *Maryland v. B. & O. RR Co.,* 22 Wall. 105 22 L. Ed. 713-714 citing English cases).

The words "due process of law" when applied to judicial proceedings mean a course of legal proceedings

according to those rules and principles which have been established in our system of jurisprudence for the protection and enforcement of private rights *(Pennoyer v. Neff,* 95 US 714, 733, 24 L. Ed. 565; *Endicott-Johnson Corporation v. Smith,* 266 US 285, 288, 45 S. Ct. 61, 62). In determining whether or not due process of law has been denied, regard must always be had to the character of the proceeding involved for the purpose of determining what the practice at common law was and what the practice in this country has been in like cases *(Twining v. New Jersey,* 211 US 78, 100, 29 S. Ct. 14; *Crane v. Hahlo,* 258 US 142, 147, 42 S. Ct. 214, 215).

The Fifth Amendment, which guarantees due process of law, is a restraint upon the judicial powers of the government as well as upon the legislative and executive powers *(Hovey v. Elliott,* 167 US 409, 17 S. Ct. 841, 844; *Den v. Hoboken L & I Co.,* 18 How. 272, 15 L. Ed. 372, 374).

By requiring the payment of royalty in excess of that provided for in the contract, the Court of Appeals has usurped a power which does violence to the established rules and principles of our jurisprudence. The action of the Court of Appeals does not conform to any rational administration of justice. Rather, it is arbitrary action ignoring plain rights. Such usurpation of power deprives the petitioners of property without due process of law in violation of the Fifth Amendment.

**4. The Action of the Court of Appeals in Rewriting the Contract is a Denial of Liberty to Contract in Violation of the Fifth Amendment.**

By assuming the power to rewrite the contract, the Court of Appeals has denied to the petitioners their constitutional freedom of contract. In the place of a contract made voluntarily the Court imposes on the petitioners a contract carrying substantially heavier burdens.

The freedom of the people to enter into and carry out contracts in respect of their property and private affairs is a matter of great public concern and such liberty may not lightly be impaired *(Highland v. Russell Car & Snow Plow Co.,* 279 US 253, 261, 49 S. Ct. 314, 316; *Steele v. Drummond,* 275 US 199, 205, 48 S. Ct. 53). Generally speaking that right is protected by the due process clauses of the Fifth and Fourteenth amendments *(Allgeyer v. Louisiana,* 165 US 578, 591, 17 S. Ct. 427; *Highland v. Russell Car & Snow Plow Co., supra).* It is also well established, however, by exceptions to the rule that such liberty is not absolute or universal and that Congress may regulate the making and performance of such contracts whenever reasonably necessary to effect any of the purposes for which the national government was created *(Highland v. Russell Car & Snow Plow Co., supra; Frisbie v. United States,* 157 US 160, 165, 15 S. Ct. 586).

The case at bar does not come within the recognized exception to the rule (Cf. *West Coast Hotel Company v. Parish,* 300 US 379, 57 S. Ct. 578). Here Congress, in protection of the national interest in 1935, changed the method of leasing Federal public land. This action by Congress was proper. But it clearly does not have the effect of removing private parties from the protection of the Fifth Amendment insofar as their rights to contract are concerned. The change in the law is no excuse for an exercise of the judicial power in a manner entirely contrary to the established principles of our system of jurisprudence.

The Fifth Amendment is just as binding on the judicial as on the executive and legislative departments *(Hovey v. Elliott, supra; Den v. Hoboken L. & I Co., supra; Bass v. Hoagland,* (CCA 5th 1949) 172 F. (2d) 205, 209). Accordingly, the action of the Court of Appeals in denying freedom of contract in this case is in the same category as would be an act of Congress or an administrative order of the executive department. The result of such action is that

the petitioners have been deprived of liberty without due process in violation of the Fifth Amendment.

**5. The Existence of a Trust Relationship Does Not Make Valid the Action of the Court of Appeals.**

The Court of Appeals held that there was a trust relationship; that flexibility is one of the virtues of equity; that equity will not be denied by the imposition of intervening legislation; and that in equity and good conscience the respondents are entitled to an overriding royalty of 4% (R. 620-621).

We deny that there was any trust relationship but for the purpose of this argument let us assume that the Court of Appeals rightly held that a trust relationship existed. Such a fact does not either justify or empower the court to rewrite the contract.

The rights of the respondents are dependent solely upon the 1926 contract. It is the basis for whatever trust there may be. It establishes whatever rights the respondents may have. The trustees are bound to no greater duties or obligations than are imposed by that contract.

If this case involves a trust, it is a constructive trust (see opinion of Court of Appeals, R. 618). There is and may be no express trust conjured out of the circumstances here presented. A constructive trust is substantially a remedy against unjust enrichment (54 Am. Jur. 169). If there is a constructive trust here it is because of the equitable duty of the present producer of oil to pay royalties as required by the 1926 contract. Such equitable duty does not obligate the trustee to do more than was required by the 1926 contract. Yet the court has required substantially more to be done.

The whole difficulty in this case arose from the failure of the permittees or their successors to take any action when petitioner McLaughlin applied for an exchange lease.

By proper objection to the issuance of such lease they could have protected themselves. They failed to do so. Now, after production has been obtained, they come forward claiming rights under the old contract and are met with the objection that the existing law prevents the operation of the royalty payment provisions of the contract. Assuming that they be entitled to protection the Court comes forward with a remedy which imposes substantially greater burdens on the oil producer.

We have heretofore shown that a court of equity cannot rewrite a contract. This Court in discussing the powers of a court of equity said (*Rees v. Watertown,* 19 Wall. 107, 22 L. Ed. 72, 76):

> "A court of equity cannot, by avowing that there is a right but no remedy known to the law, create a remedy in violation of law, or even without the authority of law. It acts upon established principles not only, but through established channels."

In the case at bar by changing the contract so as to impose additional burdens upon petitioners, the court has acted contrary to established principles.

## II.

## THERE IS NO TRUST RELATIONSHIP BINDING ON THE PRODUCER OF OIL

### 1. The 1926 Contract Does Not Apply to Extension or Renewal Leases.

The pertinent language of the 1926 contract covering the payment of royalties on oil and gas produced on the lands in question has been heretofore set out. The language contained therein is not the language of reservation of an interest in the property assigned, instead it is a mere promise to pay.

The 1926 contract contains no provisions whatsoever

relative to extension or renewal leases. It must not be confused with assignments of permits or leases which by their express terms provide that the agreed royalty shall be payable out of production secured under extension or renewal leases. In the absence of such a provision the well recognized general rule is that royalty is not payable under an extension or renewal lease. In Summers on Oil and Gas, Vol. III, Sec. 554, Page 320, the principle is stated thus:

> "The mere assignment of an oil and gas lease creates no such fiduciary relation. If it is created, it must be by the terms of the assignment."

The principle that an assignee of an oil and gas lease is not bound to pay a royalty reserved in such assignment out of production under such extension or renewal lease, when the assignment does not make the royalty provision applicable to extension or renewal leases, is well established *(Gordon v. Empire Gas and Fuel Company,* (C.C.A. 5th, 1933), 63 F. (2d) 487, cert. den. 289 U. S. 751, 77 L. Ed. 1496, 53 S. Ct. 696; *Hawkins v. Klein,* 124 Okla. 161, 255 Pac. 570; *Goocey v. Hopkins,* 206 Ky. 176, 266 S. W. 1087, *Henry v. Gulf Refining Co.,* 179 Ark. 138, 15 S. W. (2d) 979; *Thomas v. Warner-Quinlan Company,* (Tex. Civ. App.) 65 S. W. (2d) 321; *Burns v. Loftus,* 32 Nev. 55, 104 Pac. 246; *Flats-Marks Realty Company v. Silvers Lunch Stores, Inc.,* (C.C.A. 2nd, 1934) 74 F. (2d) 210; and the very recent Louisiana case of *Wier v. Glassell* (not yet officially reported)—So. (2d)—).

The decision here is in direct conflict with that of the Fifth Circuit in the closely analogous case of *Gordon v. Empire Gas and Fuel Company, supra.*

The prospecting permit assigned by the 1926 contract expired by operation of law on December 31, 1938 (R. 447). McLaughlin then secured an exchange lease under the 1935 act, and that lease expired on December 31, 1943 (R.

458). Levison and Gray then secured a new lease under the 1942 Act (R. 485). The only production from the land was secured under the last lease. In view of the fact that the royalty provisions of the 1926 contract did not by their terms apply to extension or renewal leases, they do not apply to production under the 1944 lease.

**2. The Condition Precedent Contained in the 1926 Contract Never Occurred.**

The promise to pay royalty contained in the 1926 contract in definite and certain terms was conditioned on the issuance of dual leases, one of which should carry a minimum Government royalty of 5%. Dual leases were never issued. The lease under which the production is secured carried a minimum Government royalty of 12½%. Hence, the condition precedent never occurred and under the existing law can never occur.

If a promise is in terms conditional, performance becomes due only upon the happening of the condition (Restatement of the Law of Contracts, Vol. 1, page 111, Sec. 91; 17 C. J. S. 938; 12 Am. Jur. 883; *Southern Surety Company v. MacMillan Company,* (C.C.A. 10th, 1932) 58 F. (2d) 541.

**3. Impossibility of Performance under the 1935 Act of the Agreed Condition Precedent to Royalty Payments Destroys Those Provisions of the 1926 Contract.**

The royalty provisions of the 1926 contract were impossible of performance after the passage of the 1935 Act because there were no more dual leases and no more minimum Government royalty of 5%. The well recognized general rule is that a contractual duty is discharged where performance is prevented or prohibited by law. In *Otis and Company v. Securities and Exchange Commission,* 323 U. S. 624, 638, 65 S. Ct. 483, 490, this Court said:

> "Where preexisting contract provisions exist which produce results at variance with a legislative

policy which was not foreseeable at the time the contract was made, they cannot be permitted to operate."

The fact that the contract was valid when made is of no avail to the respondents (see Restatement of the Law of Contracts, Vol. 2, Secs. 458 and 608; *Fordham v. Cooper,* 70 Colo. 529, 202 Pac. 1086, *Parrish v. Stratton Cripple Creek Mining and Development Co.,* (C.C.A. 10th) 116 F. (2d) 207-209, *U. S. v. Gleason,* 175 U. S. 588, 20 S. Ct. 228).

In *Cummings v. Clark,* 282 Fed. 300, the court considered a case where the situation of the contracting parties was radically changed by an intervening statute. The Court said (p. 303):

> "We start with general principles over which there is no controversy. *One is that a contract, the performance of which is prevented by a legal impossibility, subsequently created by law, cannot be enforced."* (emphasis supplied)

The decision of the district court in the last quoted case was affirmed by the Third Circuit Court of Appeals, which said (*Cummings v. Clark,* 2 F. (2d) 442, 443):

> "The contingency against which the parties provided, the legislation of Illinois, prevented Cummings from carrying out his contract, and we agree with the court below that the defendants were not bound to accept stock which was on a different capitalization basis from that of the contract. *For the law to hold otherwise would practically be for the courts to write and enforce as a contract what the parties had never made their contract."* (Emphasis supplied)

**4. The Provisions of the 1926 Contract for Royalty do Not Attach to a Lease Under the 1942 Act.**

The only production which has been secured from the land in question has been under a lease dated January 1,

1944 issued pursuant to the Act of July 29, 1942. This act (56 Stat. 726) provides for the issuance of new leases and contains no savings or inuring clauses protecting rights which existed under former statutes. In Section 19 of the 1935 Act (49 Stat. 679) there were inuring clauses designed to protect the rights of persons affected thereby. No such clause is found in the 1942 Act, which provides that "the record title holder shall be entitled to a preference right over others to a new lease for the same land."

The legislative history of the 1942 Act makes it abundantly clear that it was intended to permit the issuance of a new lease free and clear of obligations which might attach to former leases. Phillips' Exhibit No. 1 (R. 586-587) is the Senate committee report on the bill which states clearly that the preference right created by the act is to apply to "new leases of the lands but on the same terms and conditions as a lease would be granted to other applicants." Clearly other applicants could not be subject to the current efforts to impress a trust upon the new lease.

**5. The Decision of the Court of Appeals Violates Valid Federal Regulations.**

Section 192.83, 43 C.F.R. prohibits the creation of overriding royalty obligations aggregating in excess of 5% except in certain conditions not pertinent to this inquiry. The Court of Appeals has prescribed a royalty of 7½% on gas which clearly violates the regulation. The decision also requires payment of 4% overriding royalty on oil which, when combined with the 2½% to which Levison and Gray are entitled under an already approved contract (R. 486, 487), aggregates an amount in excess of that permitted by the regulation.

**6. The Claims of the Respondents are Barred by Laches.**

There is no evidence presented that any of the respondents, their predecessors in interest, or agents, did any-

thing in connection with the lands involved in this suit between 1935 (R. 441-443) and the fall of 1945 after Phillips had begun drilling (R. 306). For ten years the respondents stood by and did nothing. Their actions resulting in the filing of this suit came after the discovery of oil and the expenditure of $800,000 by petitioner Phillips Petroleum Company (R. 308).

The lack of interest which the respondents and their predecessors in interest had in this matter is shown by the fact that admittedly the inventories filed prior to 1947 in the estates of deceased original permittees made no mention of the claim of ownership in and to the oil and gas royalties or the land which is the subject matter of this suit (R. 609).

The factors which in this case impel the invocation of the doctrine of laches are most apparent.

## CONCLUSION

For the reasons assigned we ask that a writ of certiorari issue to the end that the judgment of the Court of Appeals may be reversed and that the judgment of the district court dismissing the complaint be sustained.

Respectfully submitted,

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APPENDIX A

PARTS OF

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IN THE

# Supreme Court of the United States

OCTOBER TERM, 1949

**No. 673**

NELLIE IONE GRAY, EVLYN LEVISON, A. C. McLAUGHLIN, and the PHILLIPS PETROLEUM COMPANY,

Petitioners,

vs.

AMBROSE OLDLAND, CARRIE KNOWLES, ERNEST OLDLAND, GERALD OLDLAND, WALTER OLDLAND, CECILIA H. YOUNG, as sole Heir at Law of Leonard J. Young and as sole Legatee and Devisee under the last will and testament of said Leonard J. Young, Deceased, THOMAS A. YOUNG, MABEL McGLINN DIAGNAULT, MARGARET McGLINN, ESTELLE CONNER WAIT, HENRY W. CONNER, RUTH CONNER WILLS, LEONARD McGLINN, IRVING A. WYNN, CARLYLE WYNN, JR., CARLYLE WYNN, SR., MARION P. McGLINN, a minor appearing by her next friend, Ernest Oldland, WILLIS SAXE MONTGOMERY III, MARCELLE MONTGOMERY ELLIS, E. C. PARSONS, M. K. ANDREW, WILLIAM K. PARSONS, ELIZABETH G. CARNEY, THOMAS F. CARNEY, MARIE LOUISE CROCKETT, WILLIAM CHARLES CARNEY, BETTY CARNEY, also known as Elizabeth Carney, and ERNESTINE CARNEY, Minors, appearing by their next friend, Elizabeth G. Carney, HARRIETT ROSE KIMBALL, JOHN WATSON CARD, as Executor and Devisee under the last will and testament of Maggie Moog, Deceased, BENNETT C. SHIDELER, ELIZABETH R. WELTON, CORDENIA C. MILLER, OLIVE O. JOHNSTON, LILLIAN STEVENSON, CHARLES W. BANTA, ANNA REES, AVIS NEAL ROEMER, JOE TRACHTA, JOE JUHAN, CHARLES J. PEARSALL, HATTIE P. JOCELYN, CLIFFORD R. PEARSALL, RICHARD PEARSALL, ALICE P. HEINDEL, MARY PEARSALL, RAYMOND PEARSALL, CLAIRE P. PLATTER, FRANCIS M. SHIDELER, BYRON H. SHIDELER, JOHN CHESTER SMITH, an infant, by his next friend, Joseph J. Shideler, ELEANOR HASKINS, ROBERT W. SHIDELER, WALTER M. SHIDELER, EDWARD T. WILLIAMS, THOMAS EDWARD WILLIAMS, an infant, by his next friend, Joseph J. Shideler, JOSEPH J. SHIDELER, ROSE MYRTLE RECTOR, as heir at law and administratrix of the estate of James William Rector, Deceased, JAMES RICHARD RECTOR, RUBY RECTOR KIRBY, and LEONA RECTOR HINRICKS.

Respondents.

## BRIEF OF RESPONDENTS AMBROSE OLDLAND AND OTHERS RESISTING PETITION FOR WRIT OF CERTIORARI

### STATEMENT OF THE CASE

The respondents who join in this brief own ninety percent of the entire royalty interest involved in this proceeding. The other ten percent is owned by Rose Myrtle Rector,

James Richard Rector, Ruby Rector Kirby and Leona Rector Hinricks, who are represented by other counsel.

The opinion of the Circuit Court of Appeals in this case is now reported in 179 Fed. (2d) 408.

The petitioners' statement of the case is neither complete nor fully accurate. A fuller and more accurate statement is necessary to understand the principles of law followed by the United States Circuit Court of Appeals of the Tenth Circuit, hereinafter referred to as the Tenth Circuit Court of Appeals. All exhibits to which reference is made herein were admitted in evidence by pre-trial order (R. 84-94). The facts are as follows:

The individuals referred to in the opinion of the Circuit Court of Appeals as the Oldland Group, of which Ambrose Oldland is the only surviving member, the other respondents being successors in interest or grantees of one or more of the original members of the group, located certain placer mining claims in the year 1901 (R. 379-383). The claims were kept in good standing by the performance of annual assessment work up to 1919, in which year the Grantees drilled shallow wells on each of the claims included in said lands and discovered small quantities of oil (R. 218-222-224). In 1948 these oil wells were identified and located by actual survey on the ground. It is established that said wells are on the property now operated by the Phillips (R. 216-224, Plaintiffs' Ex. 42, R. 531).

The records of the Land Office also show that said wells were drilled and some oil was discovered (R. 369-395 and 398-424).

After the enactment of the Leasing Act of 1920 the Oldland Group first applied for and obtained a lease on the lands described in the complaint, together with other lands (R. 401, 402, 409, 414, 415, 435). Because the Secretary of the Interior ruled the Oldland Group must pay rental of

One Dollar per acre, retroactive to 1920, the Oldland Group eventually elected to take part of the lands under a lease, later assigned to the Texas Company and not involved in this action, and applied for a prospecting permit on the lands which are involved in this action (R. 374).

On November 25, 1925, C. T. Carney gave an option to H. W. Gray for an assignment of said permit (R. 520). The option was exercised by H. W. Gray (R. 517), but the assignment was made to the defendant A. C. McLaughlin. A copy of the assignment is attached to the Complaint (R. 13-18). The assignment was not filed in the United States Land Office until about October 18, 1938 (R. 451, 456, 282).

A material part of the assignment not quoted in petitioners' statement of the case reads as follows:

> "The said Assignee covenants and agrees to carry on such drilling and operations on said permit area as to fulfill the terms and conditions of said permit within the period therein prescribed or any extensions thereof. Assignee, for the purpose of carrying on such drilling operations is hereby granted the right to use the Star Drilling Machine, Boiler and Tools of said Oldland Group, without cost or expenses therefor to said Assignee.
>
> "It is understood and agreed by the parties hereto that notwithstanding anything in this agreement to the contrary, Assignee shall have the right at any time to terminate this agreement and to discontinue all operations upon said property and to abandon such property and to deliver same back to the Oldland Group; provided that upon abandonment, Assignee shall quitclaim and re-assign to said Oldland Group all right, title and interest as acquired hereunder in and to said permit and shall pay said Oldland Group the sum of Two Thousand Dol-

lars ($2,000.00), if at the date of said re-assignment Assignee shall not have complied with the drilling requirements of said permit, and receipt of such sum of $2,000.00 by said Oldland Group shall be construed as full release of Assignee from any and all obligations hereunder.

"This agreement shall inure to the benefit of and be binding upon the heirs, representatives, executors, administrators and assigns of the parties hereto."

The prospecting permit, (R. 389) paragraph 2, required the permittees, within six months from the date of the permit, to install upon some portion of the land covered thereby, a drilling outfit and to commence actual drilling operations and to drill one or more wells to a depth of not less than 500 feet within one year from the date of the permit. Section 4 of the permit (R. 389) provides that within two years from the date thereof the permittees shall drill one or more wells to a depth of at least 2,000 feet unless valuable deposits of oil or gas shall be sooner discovered.

Petitioner McLaughlin made, or caused to be made through Consaul and Heltman, Washington, D. C., attorneys employed by him (R. 279, 284 and 440), many applications for extension of time to comply with the requirements of said permit. These applications were based on the equities of the original mining locators, particularly the fact that wells showing some quantities of oil had been drilled by the locators on all the claims and at considerable expense (R. 397-406, 409-411, 413, 415, 423-428). The next to the last extension granted was to December 31, 1937 (R. 444). The last extension was to December 31, 1938 (R. 447). Before the last extension was made McLaughlin applied for an exchange lease (R. 445). After being notified that all permits in good standing were automatically extended to

the end of 1938 he withdrew his application for a lease and accepted the extension of the term of the permit (R. 446). In 1938 he again applied for an exchange lease (R. 448). In connection with said application and to obtain a lease he made affidavit in which he stated that if the lease were issued to him he would be obligated to pay the said permittees a royalty of 4% of the oil produced from said premises (R. 451).

In all the proceedings before the Land Office Charles T. Carney acted as Attorney in Fact for the other permittees (R. 378-379). Charles T. Carney died May 5, 1938 (R. 551).

Upon receipt of the McLaughlin application for an exchange lease, the Land Office directed notice thereof to be given the applicant McLaughlin by registered mail, and that notice be given Charles T. Carney as Attorney in Fact for the other permittees by ordinary mail (R. 450, 574). McLaughlin knew Carney was dead at that time (R. 282 and 295). He did not notify the Land Office of the death of Carney (R. 295), nor did he contact any other members of the Oldland Group (R. 229). By letter of October 18, 1939, the Commissioner of the General Land Office recommended the approval of the assignment from the Oldland Group (R. 456, 458). In November, 1939 McLaughlin quitclaimed his interest in said lease to petitioners Evlyn Levison and Nellie Ione Gray (R. 473, 474).

Levison and Gray and the Phillips Petroleum Company acquired the rights now asserted by them with full notice of the claim asserted by the Oldland Group (R. 37, 64, 591, 593).

Plaintiffs' Exhibit 3 (R. 397, 398) shows that the prospecting permit was issued under the provisions of Section 13 of the 1920 Leasing Act which set up the machinery for issuance of permits, but the permit was earned under the

terms and met with the conditions of Section 19 of the said Act (R. 435).

Section 19 of said Act provides that:

> "all permits or leases hereunder shall inure to the benefit of the claimant and all persons claiming through, or under him by lease, contract, or otherwise, as their interests may appear."

The Act of August 21st, 1935, C. 595, Sec. 2, 49 Stat. 679, subdiv. b reads as follows:

> "Nothing contained in this amendatory Act shall be construed to affect the validity of oil and gas prospecting permits or leases previously issued under the authority of Sections 181 to 194, 201, 202 to 298, 211 to 214, 221, 223 to 229, 241, 251 and 261 to 263 of this title, and in existence on August 21, 1935, or impair any rights or privileges which have accrued under such permits or leases. (August 21, 1935, C. 599, Sec. 2, 49 Stat. 679 .....)"

The statement in petitioners' brief, page 16, to the effect that the assignment was based on a consideration of $1500.00 is incorrect. The sum of $1500.00 was paid to reimburse the Oldland Group for expenditures they had made in drilling a well on the property under the terms of the permit, subsequent to the time that Gray as Agent for McLaughlin had obtained the option for an assignment of the permit. It was the understanding of the parties that the assignors of the permit were to be reimbursed for this expenditure. See Letter of Gray (R. 517); Letter of R. Oldland (R. 519-520); Option R. 279, 522).

The statement on page 4 that the prospecting permit terminated by operation of the 1935 Act on December 31, 1938 is, we submit, incorrect. Said permit was exchanged for a lease as authorized by the 1935 Act (R. 445, 446, 448, 449 and 451).

The statement on pages 6 and 7 to the effect that the decision of the Circuit Court of Appeals requires the payment of a royalty greater than stipulated in the assignment of the permit is based upon the assumption that the affidavit of McLaughlin in which he unequivocally declared that he would be obligated to pay a 4% royalty in the event a lease was issued to him is of no force or effect. This assumption as hereinafter pointed out is wholly untenable.

## II.

### RESPONDENTS' CONTENTIONS AND SUMMARY OF ARGUMENT

RESPONDENTS DENY THAT THE TENTH CIRCUIT COURT OF APPEALS REWROTE ANY CONTRACT OR IMPOSED BURDENS ON PETITIONERS NOT IMPOSED BY THE LAW OF TRUSTS. THE NEGATIVE OF THE CONTENTIONS OF PETITIONERS ARE RESTATED AND DISCUSSED HEREIN UNDER THE FOLLOWING POINTS:

1. This Court, it is conceded, has the inherent power to review the decision of a Circuit Court of Appeals in this and all other cases; this is not a case wherein such a right of review should be exercised under the established procedure of this Court.

2. The Tenth Circuit Court of Appeals neither rewrote the contract of March 15, 1926 nor attempted to add any burdens more onerous than those clearly contemplated by the agreement of March 15, 1926, interpreted in the light of the conduct of the petitioners herein.

3. The Tenth Circuit Court of Appeals did not depart from the usual and accepted course of judicial procedure in the determination of the issues in this case; on the contrary, said Court accepted and applied long recognized and well established principles of Equity Jurisprudence inherent in the law of trusts.

4. There is no conflict in the decision of the Tenth Circuit Court of Appeals in this case and any decisions of

the Supreme Court of the United States, or of the Supreme Court of the State of Colorado, or of any other Circuit Court of Appeals. When the difference in facts in the various cases are taken into consideration, all of the decisions are in harmony.

5. Because of the foregoing, there is no question of violation of the fifth amendment or denial of due process of law involved in this case.

## III.

## ARGUMENT

### POINT 1.

### JURISDICTION

THIS COURT HAS INHERENT JURISDICTION TO REVIEW THIS CASE, BUT IT IS NOT A CASE IN WHICH DISCRETIONARY JURISDICTION TO REVIEW SHOULD BE EXERCISED.

It is conceded that inherent power to review a final decision of a Circuit Court of Appeals is vested in the Supreme Court of the United States under the Constitution and under Sec. 1254, Title 28, U.S.C.A., the new Judicial Code. It is denied that this Court should review this case on writ of certiorari. There are no special or important reasons therefor as contemplated by paragraph 5 of Rule 38 of this Court. The case, when scrutinized and analyzed in the light of the admitted facts, is predicated on the law of trusts and the application of basic principles universally recognized by all courts.

In the application of these basic principles, there is no diversity of opinion between the decision of the Circuit Court of Appeals in this case and decisions in other cases, either state or federal. We submit that the foregoing appears from the opinion of the Circuit Court of Appeals and we have attempted to elaborate on this subject and demonstrate its application in the argument following herein.

**POINT 2.**

## THE CIRCUIT COURT OF APPEALS DID NOT REWRITE THE CONTRACT OF MARCH 15, 1926. SAID COURT INTERPRETED SAID CONTRACT TO ACCORD WITH THE INTERPRETATION PLACED ON THE SAME BY THE PARTIES AND PARTICULARLY BY THE PETITIONERS A. C. McLAUGHLIN AND THE PHILLIPS PETROLEUM COMPANY.

It was clearly the intent of the assignment of the permit (R. 14) that the Assignee was to drill and develop the permit lands and obtain leases under the existing law. To obtain said leases the law contemplated discovery of oil or gas. The alternative to drilling operations to discover oil and gas, open to the Assignee, McLaughlin, under the terms of the contract, was to

> "discontinue all operations upon said property and to deliver same back to the Oldland Group, provided that upon abandonment, Assignee shall quitclaim and reassign to said Oldland Group all right, title and interest as acquired hereunder in and to said permit and shall pay said Oldland Group the sum of Two Thousand Dollars ($2,000.00), if at the date of said reassignment Assignee shall not have complied with the drilling requirements of said permit."

In 1935 Congress amended the Leasing Act of 1920 to provide that a permit issued thereunder might not be extended beyond December 31, 1938. See excerpts from Act of August 21, 1935 C. 595, Sec. 2, 49 Stat. 679 printed as Appendix A attached hereto. Petitioner McLaughlin knew at all times during the period intervening between the date of the passage of the Act of 1935 and November, 1938 that he would be required, if he complied with his contract, to drill and make a discovery of oil or gas or to reassign the permit and deliver the property back to the Oldland

Group. He did neither of these things. Instead he elected to file his assignment with the Department of the Interior and ask for the issuance to him of a new lease in lieu of the prospecting permit, pursuant to the provisions of said Act as set forth in the third proviso of Appendix A aforesaid.

Pursuant to this voluntary application, he did exchange the permit for a lease. It is now contended that by such action he was able to divest the Oldland Group of all claim in the lands covered by the permit and acquire the property rights evidenced by said permit for himself and his assigns in derogation of the rights of those who had entrusted the control of the prospecting permit and the possession of the property to him.

This the Circuit Court of Appeals said he might not do because of the law of trusts. We submit if he did not wish to enjoy the privileges granted to him by the assignment of the permit, it was his duty to reassign the same to the Oldland Group and deliver the property back to them. It was not within the province of his discretion to accept the benefits and repudiate the obligations of the assignment. Apparently in 1938 and 1939 he entertained no intent to divest the Oldland Group of their rights, at least not all of their rights, because he filed a sworn affidavit in which he expressly declared that he was obligated to pay a royalty of 4% to the Oldland Group if a lease were issued to him (R. 451).

The conduct and declarations of parties may be considered in the interpretation of the meaning of a contract. 65 C. J. Sec. 250, P. 502.

The acceptance of the statements of this verified declaration of trust in aid of the construction and meaning of the contract as finally construed by the parties is not an exercise of unauthorized judicial power.

Petitioners say the Circuit Court of Appeals should have disregarded the affidavit of A. C. McLaughlin whereby he construes the duty he owes the Oldland Group as trustee. We say said declaration, standing alone, viewed in the light of the background and surrounding circumstances, is sufficient to constitute an express trust.

65 C. J. Sec. 59, page 275;

65 C. J. Sec. 62, page 280;

65 C. J. Sec. 63, page 285.

The fact that said declaration was not specifically accepted by the beneficiaries of the trust is not important. The bringing of the action itself may constitute such acceptance.

65 C. J. Sec. 78, page 317.

We urge that under the facts of this case A. C. McLaughlin and his assignee should be estopped to deny the binding effect of said affidavit.

65 C. J. Sec. 953, page 1022;

65 C. J. Sec. 1002, page 1076.

**POINT 8.**

THE TENTH CIRCUIT COURT OF APPEALS DID NOT DEPART FROM THE USUAL AND ACCEPTED COURSE OF JUDICIAL PROCEDURE IN THE DETERMINATION OF THE ISSUES IN THIS CASE. SAID COURT ACCEPTED AND APPLIED LONG RECOGNIZED AND ESTABLISHED PRINCIPLES INHERENT IN THE LAW OF TRUSTS.

We urge that one fundamental error or fallacy appears throughout the argument of counsel for petitioners in support of the assertion that the Tenth Circuit Court of Appeals rewrote the contract of March 15, 1926 and

thereby violated the Fifth Amendment of the Federal Constitution. This assertion is repeated in different forms. The fallacy in this argument arises out of the unfounded assumption that the trust claimed to exist in this case rests solely upon contract; that if it could exist at all it would be an express trust in its simplest form, in no manner fortified or colored by elements of a resulting or constructive trust. Hence, it is implied in the argument, if not said in so many words, that since the contract of assignment (R. 14) does not expressly state that the assignee is a trustee it may be breached; it may be used in violation of principles of justice and good conscience and the only remedy of the wronged party is an action for damages for breach of contract.

It is an established principle of law that no one can plead or establish his own wrong as a defense, nor can he profit by such wrong.

*Rogers v. Bruce*, 69 Colo. 298 at 300;

*Toll v. McKenzie*, 88 Colo. 582 at 589;

*Grattan v. Wilson*, 82 Colo. 239 at 244.

Courts of equity hold it is inequitable to allow a person to insist on form and thereby defeat substance.

*Secombe v. Steele*, 61 U.S. 94; 20 Howard 94 at 104.

Every intendment must be made against the construction of a contract under which it would operate as a snare.

*Utley v. Donaldson*, 94 U.S. 29 at 46; 24 L. Ed. 54.

Equity looks upon that as done which ought to be done; it imputes an intention to fulfill an obligation.

*Cropley v. Cooper*, 86 U.S. 167; 19 Wall 167 at 174;

*Minnesota Mutual Investment Company v. McGirr*, 263 Fed. 847 (C.C.A. Colo.).

We quote from 65 C. J., Sec. 7, page 218:

> "Although a trust is not considered a contractual relation, it may arise out of a contract and it may arise by implication no less than by express words * * *. Trusts are always imperative and are obligatory on the conscience of the person intrusted, they are made with strict reference to their faithful execution and it is said that the entire doctrine of trusts rests upon the principle that equity regards that as done which ought to be done."

Courts, in the enforcement of the doctrine of trusts are not always limited to the observance of the strict letter of a contractual obligation even though the trust relationship arises out of such an obligation, especially in those cases where by reason of the conduct of a party in whom confidence has been reposed, a resulting or constructive trust arises. In such cases, equity applies the maxim, "there is no right without a remedy."

It has been said that equity will invent a remedy to enforce a right where no remedy exists.

*Engineers Construction Co. v. Tolbert*, 74 Colo. 542.

At the bottom of page 27 of petitioners' brief the following appears:

> "The whole difficulty in this case arose from the failure of the permittees or their successors to take any action when petitioner McLaughlin applied for an exchange lease."

This is an astounding statement when compared with the purpose and language of the assignment of the permit. It

is more astounding when we consider that uncontradicted evidence showed that for months before the application for an exchange lease was made A. C. McLaughlin was receiving substantial royalty payments from oil produced at shallow depths in the same field (R. 231, 232). He might have secured similar production on the nearby lands involved herein had he seen fit to drill (R. 248-251). These facts should be considered in connection with the elaborate attempt appearing at pages 6 and 7 of the petition for rehearing and page 22 of the brief of petitioners to convince this Court that burdens are imposed by the decision of the Circuit Court of Appeals on Phillips Petroleum Company which were never contemplated by the assignment to McLaughlin.

The answer to this argument is in the language of the assignment and the circumstances surrounding the transaction, including the fact that Phillips Petroleum Company had full notice and knowledge of the claims and contentions of the Oldland Group before it acquired its rights or spent a dollar. If, in the year 1938, McLaughlin did not wish to comply with the drilling requirements of the permit, as he was required to do by his assignment, and to make discovery and apply for leases based thereon, he should have surrendered the permit, and the property covered thereby, to the Oldland Group and paid them the sum of Two Thousand Dollars ($2,000.00).

Instead, he elected to apply for one lease carrying a minimum royalty to the United States of 12½% instead of applying for two leases, one of which would carry a minimum royalty of 5% and the other a minimum royalty of the same amount as the lease he obtained. He did all of this without consulting his *cestuis que trustent*. If he elected to act on his own responsibility, contrary to the agreement, without any attempt to conform thereto, and thereby to obtain a benefit for himself, who should be the loser? We say

the loss should fall on McLaughlin and his assigns who took title with notice of the claims of the Oldland Group. The Circuit Court of Appeals gave petitioners the benefit of all doubts and presumptions. The petitioners, instead of complaining because they were required to pay 4% royalty to respondents (not 3.32% as petitioners now contend by another strange distortion of the language of the Circuit Court of Appeals), should feel elated because they were not compelled to pay 7½% royalty on one-fourth of the acreage involved in this litigation. If petitioners Phillips Petroleum Company, Levison and Gray are in a worse situation than if McLaughlin had used diligence to drill and make discovery, and thereby obtain two leases instead of the one, still it must be remembered that the situation arose from the acts of McLaughlin through whom the others claim and not through any default on the part of the respondents.

It is said that the allowance of a royalty of 4% to respondents superimposed on a royalty of 2½% or more, which Phillips Petroleum Company agreed to pay Levison and Gray, calls for an aggregate royalty payment in excess of the amount allowed by federal regulations. Page 32 of Petitioners' brief. There are two answers to this contention. Assuming, for the purpose of argument only, that Levison and Gray have any right to collect royalty from Phillips, the maxim, "Between equal equities, priority of time will prevail", is decisive in favor of the Oldland Group. The assignment to them was filed with and approved by the Department of the Interior long prior to the date of the Phillips-Levison-Gray deal (R. 456, 457, 458, 282).

Another answer to this contention is that regulations of the character mentioned are no defense in an action between private litigants.

*Isaacs v. De Hon,* 11 Fed. (2d) 943;

*Aronow v. Bishop,* 107 Mont. 317.

The permit is in effect a lease. The subsequent leases are merely a continuation in a slightly different form of the rights granted by the permit. The rights enjoyed by petitioners are based upon and are the direct offspring of said permit.

*Aronow v. Bishop,* 107 Mont. 317.

Neither the Act of August 21, 1935 nor the Act of July 29, 1942 made any basic or material changes in the Leasing Act of 1920. The different Acts relate to the same general subject and are to be construed in *pari materia.*

*United States v. Sweet,* 245 U. S. 563.

*Bowes v. Cannon,* 50 Colo. 262, 116 Pac. 330, cited by the Tenth Circuit Court of Appeals, in discussing the nature of a trust, states:

> "In its more comprehensive sense it embraces every bailment, every transaction by an agent or factor, every deposit, and, indeed, every matter in which the slightest trust or confidence is reposed."

*Bowes v. Cannon,* 50 Colo. 262.

Later, in discussing the doctrine as applied to the law of bailment, the Court said:

> "* * * and that, in the latter case, it is no answer for the bailee to say that he has, by his own misconduct, incapacitated himself from complying with the lawful demand of the bailor."

*Bowes v. Cannon, supra.*

No person standing in a fiduciary relation may enrich himself by gaining any personal advantage touching the

thing or subject as to which such fiduciary position exists. In Bispham's Principles of Equity (8th Ed.), page 155, Sec. 92, the following appears:

> "To use the language of a learned author, 'wherever one person is placed in such relation to another, by the act or consent of that other, or the act of a third person, or of the law, that he becomes interested for him, or interested with him in any subject of property or business, he is prohibited from acquiring rights in that subject antagonistic to the person with whose interest he has become associated.' The instance usually given of this rule is the renewal of a lease by a trustee in his own name and with his own funds, which renewal will, by the equitable doctrine now under consideration, enure to the benefit of the *cestui que* trust; and the leading authority upon the subject is the case of Keech v. Sandford, otherwise known as the Rumford Market case."
>
> *Bispham's Principles of Equity* (8th Ed.), page 155, Sec. 92.

The Tenth Circuit Court of Appeals followed this rule (R. 618 and 619). It is no innovation in the law. The same author, referring to the nature of the trust, above mentioned, states:

> "• • • and it differs from a trust by fraud (growing out of the relation of parties) in this that no fraudulent intent is even presumed to exist, but the renewal is forbidden simply on the ground of public policy alone."
>
> *Bispham's Principles of Equity* (8th Ed.), page 156, Sec. 92.

Said Court simply followed the same rule it announced many years before in the case of *Merritt Oil Company v.*

*Young,* 43 Fed. (2d) 27 and to which it adhered in the more recent case of *Blackner v. McDermott,* 176 Fed. (2d), 498. The facts in both of said cases are very similar to the facts in the case at bar. Eminent counsel who appeared in those cases apparently concluded that the decisions of the Court were correct, because no application was made to this Court for a writ of certiorari.

The same argument was made in the *Merritt* case, *supra,* that is urged now before this Honorable Court. It was there claimed that inasmuch as the contract relied upon as the inception of the trust relation, contemplated that a fee simple title to certain land was to be obtained, based upon placer locations, and instead of obtaining such a title the parties were compelled to accept, by compromise, a lesser estate in the nature of a lease and a prospecting permit that the subject matter of the trust no longer existed, and no relation of trust could be claimed. Judge McDermott of the Tenth Circuit Court of Appeals brushed all technical contentions aside in the following words:

> "Appellant further contends that it is unfair to carry the trust, originally intended for located claims, over to an oil and gas lease and prospecting permit with their attendant burdens. Appellant was not compelled to accept the lease and permit; it could have stood on its locations, and won or lost. When it accepted part in compromise of its claim for all, the rights of the *cestui* are not thereby divested; on the contrary, the trust attaches to the property received through such compromise. This contention of appellant is unfounded."
>
> *Merritt Oil Corp. v. Young,* 43 Fed. (2d) 27 at 31.

This Honorable Court has held that, as against all persons but innocent purchasers for value, (and there are

none in this case) the property of a trust and all the fruits of such property, whether in its original or altered state, continue to be subject to or affected by the trust.

*Oliver et al. v. Pyeatt,* 3 Howard 333 at 401; 11 Lawyers Ed. 622;

*United States v. Dunn,* 268 U.S. 121 at 132.

**POINT 4.**

THERE IS NO CONFLICT BETWEEN THE DECISION OF THE TENTH CIRCUIT COURT OF APPEALS IN THIS CASE AND DECISIONS OF OTHER CIRCUIT COURTS OF APPEAL, OR DECISIONS OF THE SUPREME COURT OF THE UNITED STATES OR OF THE SUPREME COURT OF THE STATE OF COLORADO.

The cases cited by petitioners on pages 11 and 12 of their brief do not apply because no one of those cases deals with a trust relationship. In every case cited the Court held that a contract must be enforced as written, or not at all, but in none of them do we find a situation where one to whom property is entrusted, under such circumstances that a fiduciary relation arose, attempted to justify by this principle of law an advantage gained by him personally at the expense of the trust estate. None of those cases hold that in such a case the Court may not go beyond the literal words of the written contract to find a remedy. Said decisions are not applicable simply because they apply to entirely different situations. The Tenth Circuit Court of Appeals applied principles recognized by the decisions of this Court and the Supreme Court of the State of Colorado. Wherever a similar principle and state of facts were involved, the same solution was reached by the Courts. There are no conflicts in the decisions.

It is contended that the decision of the Tenth Circuit

Court of Appeals is contrary to the case of *Cummings v. Clark,* 2 Fed. (2d), 442, 443, in which an action was brought to recover the amount alleged to be due on a contract to purchase stock in a corporation. There was no relationship of trust. There was no element of unjust enrichment. The facts did not call for the interposition of a court of equity to prevent a trustee from profiting from acts which worked to his own advantage and the disadvantage of his beneficiaries.

In the case of *Gordon v. Empire Gas & Fuel Co.,* 63 Fed. (2d), 751, an oil and gas lease was granted pursuant to petition and order of a guardian's court, under a statute which expressly limited the duration of the term of the lease to the period of the minority of the minors who owned the land. The lease was assigned with the reservation of an overriding royalty payable to the assignor, and it was expressly stipulated that the payments of overriding royalty under the assignment were to continue for the term of the lease. The assignee prior to the expiration of the existing lease obtained a new lease which was in no way based upon any preference right arising out of the old lease. The new lease was entirely independent of any rights based on the old lease. These facts distinguish that case from the case now before this Court for consideration.

**POINT 5.**

## THERE IS NO QUESTION OF VIOLATION OF THE FIFTH AMENDMENT OR DENIAL OF DUE PROCESS OF LAW INVOLVED IN THIS CASE.

The Tenth Circuit Court of Appeals did not rewrite the contract nor did it impose greater burdens than McLaughlin was required to assume under the original contract. Phillips Petroleum Company who is now objecting to the payment of royalty took its title with full notice of the facts and stands in no better position than McLaughlin.

## CONCLUSION

We believe many arguments now adduced by petitioners of which laches is an example have been so effectively disposed of by the Circuit Court of Appeals, it would be an imposition on the time of the Court to discuss them.

The argument made in this court is almost the same as set forth in the petition for rehearing before the Circuit Court of Appeals (R. 623, 632). It is in effect a reargument of the case as it was presented below. This, we submit, is not the purpose to be accomplished by a proceeding of this character. We urge that the Court should decline to issue a writ of certiorari.

Respectfully submitted,

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APPENDIX A

EXCERPTS FROM ACT OF AUGUST 21, 1935

(Sec. 221) "• • • Provided, That all permits outstanding on August 21, 1935, which on said date were not subject to cancellation for violation of the law or operating regulations and which have theretofore been extended by the Secretary of the Interior, shall be extended until December 31, 1937, subject to the applicable conditions of such prior extensions: Provided further, That the Secretary of the Interior is authorized to extend for an additional period of not to exceed one year any permit on which diligence has been exercised or on which drilling or prospecting has been suspended at the direction of the Secretary during the extension period hereby granted, but no extension of any permit beyond December 31, 1938, shall be granted under authority of sections 181 to 194, 201, 202 to 208, 211 to 214, 221, 223 to 229, 241, 256 and 261 to 263 of this title, or any other Act.

• • • • •

"Provided further, That any person holding a permit to prospect for oil or gas which shall not be subject to cancellation for violation of the law or operating regulations or which shall have been extended under the authority of sections 181 to 194, 201, 202 to 208, 211 to 241, 221, 223 to 229, 241, 256 and 261 to 263 of this title or any other Act, in force on or after August 21, 1935, or for which timely and acceptable application for extension shall have been filed prior to said date, shall have the right prior to the termination of such permit to exchange the same lease for a lease to the area described in the permit without proof of discovery, at a royalty of not less than 12½ per centum or value of the pro-

duction, to be determined by the Secretary of the Interior by general rule and under such other conditions as are fixed in Section 226 of this title: Provided further, That no such lease shall be subject to the acreage limitations of section 184 of this title, until one year after the discovery of valuable deposits of oil or gas thereon: Provided further, That any application for any prospecting permit filed after ninety days prior to August 21, 1935 shall be considered as an application for lease under section 226 of this Title: And provided further, That upon leases so granted in lieu of existing permits or granted to applicants for permits, no rentals shall be payable for the first two lease years, unless valuable deposits of oil or gas are sooner discovered within the boundaries of such lease. (Feb. 25, 1920 c. 85, Sec. 13, 41 Stat. 441, as amended Aug. 21, 1935, c. 599, Sec. 1, 49 Stat. 674.)"

(Sec. 223a) "New leases in lieu of old; terms and conditions. (a) The Secretary of the Interior is authorized to issue new leases to lessees holding oil or gas leases under any of the provisions of sections 181 to 194, 201, 202 to 208, 211 to 214, 221, 223 to 229, 241, 251 and 261 to 263 of this title on August 21, 1935, such new leases to be in lieu of the leases then held by such lessees and to be at a royalty rate of not less than 12½ per centum in amount or value of the production and upon such other terms and conditions as the Secretary of the Interior shall by general rule prescribe: Provided, That no limitation of acreage not provided for under the law or regulations under which any such old lease was issued shall be applicable to any such new lease.

"(b) Nothing contained in this amendatory Act shall be construed to affect the validity of oil and

gas prospecting permits or leases previously issued under the authority of sections 181 to 194, 201, 202 to 208, 211 to 214, 221, 223 to 229, 241, 251 and 261 to 263 of this title, and in existence on August 21, 1935, or impair any rights or privileges which have accrued under such permits or leases, as printed in 30 U.S.C.A. Sections 221 and 223a. (Act of August 21, 1935 c. 595, Sec. 2, 49 Stat. 679.)"

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IN THE

# SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1949.

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No.....

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NELLIE IONE GRAY, EVLYN LEVISON, A. C. McLAUGHLIN, and the PHILLIPS PETROLEUM COMPANY, PETITIONERS,

vs.

AMBROSE OLDLAND, et al, RESPONDENTS.

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## BRIEF OF RECTOR GROUP OF RESPONDENTS UPON PETITION FOR WRIT OF CERTIORARI

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### STATEMENT OF THE CASE

This brief in response to a Petition for Writ of Certiorari is filed on behalf of what is known as the "RECTOR GROUP" of Respondents, which group is composed of ROSA MYRTLE RECTOR, as Widow and Administratrix of the Estate of JAMES WILLIAM RECTOR, Deceased, JAMES RICHARD RECTOR, RUBY RECTOR KIRBY and LEONA RECTOR HINRICKS, son and daughters of the said JAMES WILLIAM RECTOR, Deceased and said ROSA MYRTLE RECTOR.

Due to the inadequacy and incorrectness of Petitioners'

Statement of the case, these Respondents set forth below a brief statement thereof based upon the undisputed evidence in the record.

JAMES WILLIAM RECTOR, now deceased, during his lifetime was one of the original ten pioneers in Rio Blanco County, Colorado, who on or about the year 1901 filed on the oil and gas land in controversy in this action under the OIL PLACER CLAIM ACT.

JAMES WILLIAM RECTOR died in Mesa County, Colorado, on the 20th day of December, 1942, and his estate was duly probated and the Respondents above named, under the proper statutory proceedings in the County Court of Mesa County, were decreed to be the heirs-at-law of JAMES WILLIAM RECTOR, Deceased.

ROSA MYRTLE RECTOR, as surviving widow, was decreed to be the owner of an undivided one-half interest of the aforesaid estate and the three surviving children above-named were decreed to be the owners of an undivided one-sixth interest each in and to the aforesaid estate. (R. 552)

The original group of the ten pioneer placer claimants including James W. Rector continued to hold possession under their oil placer claims, expended considerable money upon shallow drilling operations, and after the passage of the Federal Oil Leasing Act of 1920, applied for an oil prospecting permit on the land in question (R. 384-387). The permit was issued February 5th, 1924, and provided if production were obtained, a royalty of 20% be paid to the United States until the permittees should apply for a Federal lease (R. 389-392). The Statute in effect at that time provided that a "Permittee" might apply for and obtain a lease for a royalty to the United States of 5% on one-fourth of the permit acreage and a graduated royalty on the balance of the acreage.

On March 15th, 1926, the Oldland Group (ten original

pioneers), one of whom was Respondents' ancestor, JAMES WILLIAM RECTOR, executed an assignment of the permit to A. C. McLAUGHLIN, an experienced oil man (R. 13-19). By the terms of this instrument McLaughlin agreed to "fulfill the terms and conditions of said permit within the period therein prescribed, or any extensions thereof". He was granted the use of drilling equipment of the OLDLAND GROUP for this purpose. He was given the right to terminate his obligations under the assignment by reassignment to the OLDLAND GROUP and payment of $2,000.00 if he had not complied with the drilling requirements of the permit. In the event of discovery, he was obligated to apply for leases and to have the privilege of designating the one-fourth of the area upon which the Government royalty should be 5%. The agreement then provides:

> "That in the event of leases being issued to Assignee embracing respectively one-quarter and three-quarters of said permit area, Assignee shall pay out of production secured thereon royalties due the Government as in said leases prescribed and shall pay to said Oldland Group a royalty of 7½% of the market value at the time produced of the oil produced and saved on said lease embracing one-quarter of the permit area in which a Government royalty of 5% is prescribed and shall pay to said Oldland Group a royalty of 4% of the market value of the oil produced and saved on said lease embracing three-quarters of the permit area in which a graduated Government royalty is prescribed" (R. 15).

There are additional royalty provisions effective as to production of gas and casinghead gasoline. The agreement is specifically made binding upon assigns of the parties (R. 16).

The execution of the agreement itself did not end the efforts and activities of the Oldland Group in seeking to preserve the fruits of their hopes, visions and expenditures

over several previous decades. In addition to using the drilling equipment of the Oldland Group, McLaughlin used the active member and agent of said OLDLAND GROUP, one C. T. CARNEY, attorney in fact for said group, time after time to make recital under oath to the Secretary of the Interior of the hardships Carney and the other members of the group had undergone while placer claimants, in order to procure extension after extension of the drilling requirements of the permit. These applications for extension were accomplished through attorneys in Washington, D. C. employed by McLaughlin because of their expert knowledge in handling matters before the Secretary of the Interior.

The Land Office files (R. 394-442) reveal how repeatedly and eloquently McLaughlin and his attorneys relied in their applications upon the hardships, expenditures and equities of the pioneer placer claimants. Although employed by McLaughlin, these attorneys appeared in the Land Office as representing the Oldland Group and did not file with the Department of the Interior the assignment to him of the permit.

McLaughlin first appears in the Land Office files in a letter by him to the Secretary of the Interior dated March 11, 1935, asking for more time to drill and containing the statement:

> "I am and have been for some years past, holder of *operating rights* under the oil permit of Charles T. Carney, et al," (R. 438).

After the first appearance by McLaughlin in the land Office records, Carney continued to appear there for the original permittees. The permit was extended from time to time to December 31, 1937.

By his application for a lease of December 7, 1937, (R. 445), McLaughin for the first time designated himself as assignee of the permit. At this date change in the statute

had made a further extension of the permit unlikely. With his application he filed a photostatic copy of the assignment. When on December 23, 1937, the Secretary extended all valid permits to December 31, 1938, McLaughlin hastily withdrew his application for a lease (R. 446). The Denver Land Office was in April, 1938, directed by the Commissioner of the General Land Office to notify the parties interested in the permit that the "permit may not be extended beyond December 31, 1938, but the right to prospect the land may be continued under lease by the filing on or before that date of an application to exchange the permit for a lease under the provisions of the Act of August 21, 1935." (R. 447-448)

In November, 1938, McLaughlin applied for such lease (R. 448).

Under oath in his affidavit dated February 16, 1939, as to his qualifications to hold a lease, McLaughlin states:

> "That in the event of a lease being granted pursuant to his application of November 21, 1938, in exchange for Prospecting Permit Denver 033623, he is obligated to pay four per cent (4%)royalty to the Permittees specified in said Permit." (R. 451)

At this time C. T. Carney and several others of the original Oldland Group were dead and known by McLaughlin to be deceased (R. 288). Of course, the power of attorney under which Carney acted for the Oldland Group terminated at Carney's death.

Lease was issued to McLaughlin dated back to December 31, 1938, for a term of five years and as long thereafter as oil or gas was produced in paying quantities. It provides for a graduated royalty to the Government. (R. 458-470).

In November, 1939, in order to qualify himself to hold another government lease in the Rangely field, (R. 286) McLaughin quitclaimed one-half interest in this lease to his daughter, Evlyn Levison, and the other half interest to

Nellie Ione Gray, wife of H. W. Gray (R. 473-474). H. W. Gray originally negotiated for the Oldland group assignment and claims that he was the silent partner of McLaughlin in the permit from the beginning. (R. 342)

It is admitted there was no consideration for these quitclaims and that McLaughlin at the time expressly advised his grantees in writing of the Oldland Group's original assignment and subjected the interest quitclaimed to the 4% royalty provision of the assignment. (R. 518-519)

Phillips Petroleum Company commenced in late 1943 negotiations with Levison and Gray to acquire the lease (R. 267), but before any agreement was consummated between them, Phillips had learned of the Oldland Group's interest from examination of the Land Office files. The assignment to McLaughlin had also been of record in Rio Blanco County, where the land is situated, since 1932.

The state of mind of Phillips at the time is well expressed in the letter of its agent, Robert P. Reid, to H. W. Gray, who was representing his wife and Mrs. Levison, on March 10, 1944, as follows:

> "I am terribly afraid that there in an outstanding royalty of 4% on oil produced and 7½% on gas, reserved unto the original permittees. The General Land Office makes a practice of only supplying those instruments that affect the chain of title. Therefore, since there is no instrument in the file showing where the Oldland Group assigned all their right, title and interest to Mr. McLaughlin, I am afraid such reservation is now outstanding." (R. 591)

To this H. W. Gray replied on March 13, 1944:

> "I would suggest that Mr. McLaughlin give you any information regarding this reservation. As to an abstract of title from the County records, you will recall I forwarded you copy stating that there was

nothing of record in Rio Blanco County pertaining to the Permit. It looks to me that if this interest is still outstanding, that readjustment will have to be made because of the new royalty rates, but I am sure Mr. McLaughlin will be able to furnish you any further information that he has." (R. 592)

Reid, Phillips agent, on June 23, 1944, wrote to H. W. Gray:

> "However, it is now known that there is a reservation of 4% on oil and 7½% on gas to the original permittees, those being the Oldland Group. Consequently, to put this lease in line for an immediate conclusion, it is advisable that you have Mr. McLaughlin settle in some way the outstanding interest. Thus we should like to be supplied with satisfactory evidence as immediately as possible that such outstanding interest has been eliminated." (R. 593)

Gray, on June 26, 1944, replied to Reid:

> "Mr. McLaughlin is in Rangely and we will get in touch with him to see Ernest Oldland who I understand represents 50% or better, of the outstanding interests—the other people are scattered all over the country and are owners of very small interests individually, and I understand that they are all deceased." (R. 595)

McLaughlin talked to Ernest Oldland, but his conversation was limited to asking Mr. Oldland what interests he had in the Rangely field (R. 291). McLaughlin insisted that any warranty be stricken out of the assignment by Levison and Gray to Phillips. (R. 289).

Phillips did all of the necessary work in the Land Office to procure a renewal or exchange lease to Levison and Gray. (R. 477-478). The lease was issued dated back to January 1, 1944, and on May 22, 1945, was assigned by Levison

and Gray to Phillips with a reservation to the assignors of an overriding royalty graduated from 2-½% to 4-1/3%. Production was obtained on the land by Phillips in 1946 and this suit was instituted when on demand of Respondents the royalty rights of the Oldland Group were denied.

The conflict between Levison and Gray on their cross-claims against Phillips, and Phillips' cross-claims against them over the construction of their agreement and lease assignment was set for seperate trial by the district court and has not as yet been heard. This conflict arises from the contention of Phillips that the Oldland Group royalty is first a charge against the royalty of Levison and Gray (R. 68-42), which contention is met with the claim of Levison and Gray that such construction would in effect deprive them of the consideration for their assignment and entitle them to a reassignment of the lease (R. 43-46). In this connection they offer on reassignment to them to reimburse Phillips for all development expenses on the property (R. 100-104).

The Hon. J. Foster Symes, trial judge in the District Court, first rendered a memorandum opinion (R. 128-143) finding for the Respondents but allowing them not the royalty reserved in their assignment to McLaughlin but only the royalty reserved by Levison and Gray in their assignment to Phillips. After extensive argument on findings of fact and conclusions of law, the trial judge revised his opinion and entered judgment against Respondents (R. 205-206).

From this judgment appeal was taken to the Tenth Circuit Court of Appeals resulting in judgment of reversal and remanding the cause of or proceedings in conformity with the opinion (R. 611-621).

When Petitioners herein petitioned for a rehearing in the Court of Appeals, they interpreted the opinion and judgment of that court as do Respondents, that is as allow-

ing to Respondents a royalty of 4% of all oil produced from the land in controversy (R. 630). In their present Petition they attempt to construe the same opinion as allowing to Respondents a graduated royalty of from 3.32% to 3.5% of the oil produced.

## SUMMARY OF ARGUMENT.

The claim of Respondents rests upon the assignment of the oil prospecting permit to McLaughlin in 1926 wherein it was provided that the Oldland Group of pioneers in the present Rangely oil field should receive a royalty of 4% on oil produced from three-fourths of the acreage on which a government lease on a graduated royalty should issue and a royalty of 7½% on the one-fourth of the acreage to be designated by McLaughlin on which the government royalty should be 5%. McLaughlin did not develop the permit nor did he terminate his obligations by reassignment as provided in the assignment. Instead, with the help of the Oldland Group, he procured extensions of the permit until by statute he was required either to develop the land and procure lease as provided under the 1920 Act or exchange the permit for a five year lease on a graduated government royalty for all the acreage. He chose the latter course, and in November, 1938, applied for exchange lease. He then filed his affidavit in support of his rights as assignee of the permit stating:

> "That in the event of a lease being issued pursuant to his application of November 21, 1938, in exchange for prospecting permit Denver 033623 he is obligated to pay four per cent (4%) royalty to the Permittees specified in said Permit" (R. 451).

It is the contention of Respondents that under the terms of the assignment to McLaughlin they were the owners of a royalty interest in oil which thereafter might be produced by McLaughlin or his assigns from the land covered by the prospecting permit and under any lease arising from said

permit. Whether this royalty interest of the Oldland Group be called legal or equitable is of no great consequence. It was a vested right and of record in Rio Blanco County in 1932 and in the General Land Office in 1938.

No contention was made below or is made here by Petitioners that the quitclaims of the lease by McLaughlin to Levison and Gray cut off any rights of the Oldland Group. Admittedly they were without consideration and with written notice to the grantees by McLaughlin quoting the royalty provision of the Oldland Group assignment and specifically subjecting the quitclaimed lease to it. (R. 518-519)

Admittedly also Phillips acquired its lease from Levison and Gray with actual knowledge of the Oldland Group's royalty. Whatever the rights may be between Levison and Gray on one hand and Phillips on the other on their cross-complaints, Respondents have no concern with them. We contend that the rights of the Oldland Group have been in no way adversely affected by the two lease transfers under the circumstances shown by the undisputed evidence. Before the law Phillips can stand in no better position than would McLaughlin had he developed the property and continued to hold the lease.

The principal contention raised on this Petition for Certiorari is one not raised in the same form below until petition for rehearing in the Court of Appeals to the effect that recognition of the Oldland Group royalty constitutes deprivation of property without due process of law contrary to the Fifth Amendment. We find no authorities in point cited by Petitioners to sustain such contention.

It would rather appear to be more appropriate for Respondents to be here complaining of their 7½% reserved royalty on one-fourth of the acreage being cut to 4%. However, the Rector Group of Respondents, who file this brief, have in the courts below consistently taken the position that the interpretation placed upon the assignment after the Act

of 1935 by the Petitioners themselves of a 4% royalty on all the acreage was agreeable to them. The argument of Petitioners that these interpretations on their part made by affidavit or otherwise to the government or among themselves and unknown to the Oldland Group were merely offers which failed for want of acceptance by the Oldland Group is too absurd for extended comment. Certainly McLaughlin's affidavit would in itself constitute a declaration of trust. Through the entire evidence can be discerned the hope and belief of McLaughlin, later joined in by Levison, Gray and Phillips that perhaps the Oldland Group would all die off and their heirs and successors never know that the Pioneers had truly found a great oil field and had not suffered and worked in vain.

It may be noted that Petitioners have consistently to the time of filing petition for rehearing in the Court of Appeals contended against the allowance to Respondents of a 7½% royalty on one-fourth of the acreage on the ground that the court could not conjecture as to which one-fourth it should be. Now they very readily identify it, as it no doubt would have been chosen, as the one-fourth first developed and closest to the center of the oil field. They then cite production figures from this "conjectural" one-fourth to attempt to add concreteness to an insubstantial argument.

## I.

## THE PETITION FOR WRIT OF CERTIORARI AND BRIEF OF PETITIONERS MISINTERPRET THE DECISION OF THE CIRCUIT COURT OF APPEALS.

In the Petition and Brief in support thereof it is contended that the decision of the Court of Appeals does not grant to Respondents a royalty of 4% of all oil produced but that it is a sliding royalty of 3.32% to 3.5% depending upon production and the amount of royalty payable to the government. This interpretation is here made for the first

time by Petitioners who in the Court of Appeals in their petition for rehearing (R. 630-631) interpreted the decision as granting Respondents a full 4% of oil produced.

The portion of the opinion below on which this new interpretation is based is quoted at Page 7 of the Petition as

> " • • • the appellants are entitled to an overriding royalty of 4 per cent of the oil and 7½ per cent of the gas produced, saved and sold from the leasehold estate, free and clear of cost, subject only to the Government royalty."

This partial quotation may, if taken alone, be ambigious. Certainly all oil produced under the government lease is subject to the government royalty. It is clear from the following quotation of the entire paragraph from which the above quotation was taken that Petitioners' interpretation is not correct.

> "When McLaughlin applied for his exchange lease under the 1935 Amendment, he acknowledged his obligation to pay the original permittee 4 per cent on all oil produced under the lease. When in 1944 Phillips was negotiating for the acquisition of the lease, a Company representative expressed the view that there was an outstanding royalty of 4 per cent of the oil and 7½ per cent of the gas 'reserved to the original permittees.' Giving full force and effect, therefore, to the provisions of the 1935 and 1942 Amendments providing for a minimum Government royalty of 12½ per cent, as well as the understanding of the parties, especially the appellees, we hold that a trust relationship was created binding upon all parties in the chain of title; that such relationship was not extinguished by the 1935 or 1942 Amendments, and that in equity and good conscience, the appellants are entitled to an overriding

> royalty of 4 per cent of the oil and 7½ per cent of the gas produced, saved and sold from the leasehold estate, free and clear of cost, subject only to the Government royalty." (R. 621)

We do not wish to burden this brief with quotations from other portions of the opinion from which it is clear that the Court of Appeals found Respondents entitled to a royalty of 4% of all oil produced under the lease.

It is strange indeed that on their petition for rehearing in the court from which the opinion issued Petitioners should have construed it as do Respondents and in this Court construe it otherwise. Had their present interpretation of the opinion been raised upon the petition for rehearing, a clarification, if one is needed, might have been anticipated from the Court of Appeals.

## II.

## THE DECISION OF THE COURT OF APPEALS AS TO RESPONDENTS' ROYALTY AS TO THREE-FOURTHS OF THE ACREAGE IS IN STRICT CONFORMITY WITH THE PROVISIONS OF THE ASSIGNMENT WHEREIN IT IS RESERVED.

Petitioners would lead this court to believe that the decision of the Court of Appeals violates the Fifth Amendment in that the rights of the Oldland Group therein decreed were created only by the imagination or ingenuity of that court and founded upon neither contract nor property right.

The present government lease on the land in question provides for a graduated royalty to the government. (R. 485)

The assignment from the Oldland Group to McLaughlin provides that he "shall pay to said Oldland Group a royalty of 4% of the market value of the oil produced and saved on said lease embracing three-quarters of the permit area in which a graduated Government royalty is prescribed" (R. 15).

It therefore is clear that as to three-fourths of the land in controversy Petitioners cannot contend there has been any rewriting of a contract by the court below. We emphasize this matter in order that this court may not apprehend from Petitioners' Brief that their argument upon this point of the Fifth Amendment extends to the entire acreage of the present lease. It relates only to one-fourth of the area involved.

## III.

## THE DECISION OF THE COURT OF APPEALS AS TO RESPONDENTS' ROYALTY IN ONE-FOURTH OF THE ACREAGE AND LIMITING IT TO 4% IS A REASONABLE AND EQUITABLE FINDING CONFORMING TO THE CONSTRUCTION PLACED UPON THE ASSIGNMENT BY PETITIONERS THEMSELVES.

At the time the permit was issued and until its expiration December 31, 1938, the permittee was entitled by the Act of 1920 if he developed the land for oil to designate one-fourth of the permit acreage for lease at a 5% royalty to the government. The balance of the acreage was to be upon a graduated government royalty.

Admittedly by failing to secure leases in this manner under the permit McLaughlin and the Oldland Group lost the right to such 5% royalty lease on one-fourth of the land. The Act of 1935 providing for issuance of no further prospecting permits and providing for prospecting of government land only upon leases with graduated royalty eliminated this contingency. There is nothing in the Act of 1935 to indicate a public policy to destroy the rights of the Oldland Group under their private agreement with McLaughlin.

The problem then becomes to determine whether this change of the statute renders part of the agreement impossible of enforcement or understanding in law or equity.

The agreement itself provides for a royalty of 7½% of

oil produced on "said lease embracing one-quarter of the permit area in which a Government royalty of 5% is prescribed" and a royalty of 4% of the oil produced on the balance under a graduated royalty to the Government. (R. 15) This provision was such that it was to the interest of McLaughlin if he qualified for such leases to designate the most productive quarter of the land for the 5% lease as the total 12½% royalty to the Government and the Oldland Group thereon would have been less than the total royalty payable upon the balance under graduated lease. While this circumstance might enable a court to determine even at this time as do Petitioners in their Petition and Brief the one-fourth on which a 5% lease would have issued, the court below has not seen fit to allow a 7½% royalty to the Oldland Group on any of the acreage. It has instead interpreted Respondents' royalty to be 4% upon the entire acreage which is all subject to a graduated government lease.

The Court of Appeals in so concluding relies not solely upon the agreement itself but points out that its conclusion is identical with the construction placed upon the agreement after the Act of 1935 by Respondents. (R. 621)

McLaughlin's affidavit filed with the Secretary of the Interior in 1939 to procure lease in lieu of the permit states that "he is obligated to pay four per cent (4%) royalty to the Permittees specified in said Permit". (R. 451) The same conclusion was reached by Phillips before it took the lease as indicated by its letter of June 23, 1944, stating: "However, it is now known that there is a reservation of 4% on oil and 7½% on gas to the original permittees, those being the Oldland Group." (R. 593)

It is obvious that if the contract was rewritten, it was rewritten not by the Court of Appeals but by Petitioners themselves, and that if anyone suffered deprivation of property by the rewriting, it was the Oldland Group whose royalty was cut from 7½% to 4% on one-fourth of the acreage.

Using the production figures from Page 7 of the Petition, this loss of royalty to Respondents is $96.25 per day. However, the Rector Group of Respondents, who file this brief, have in the courts below requested Findings of Fact and Conclusions of Law (R. 192) similar to those found by the Court of Appeals, in order to remove this question from the case, and do not now complain of this reduction of the royalty provided in the assignment.

## IV.

## THERE HAVE BEEN NO FUNDAMENTAL CHANGES IN THE NATURE OF RIGHTS GRANTED BY THE UNITED STATES TO EXPLORE AND DEVELOP ITS LANDS FOR OIL AND GAS SINCE THE ACT OF 1920.

We state briefly below the history of the Leasing Act of 1920 in order to show that no fundamental change has been made as to the rights granted private persons by the Federal Government.

Sections 13, 14 and 15 (41 Stat. 441) of the original Act provided authority to the Secretary of the Interior to grant prospecting permits for a period not exceeding two years on lands of the United States not within any known geological structure of a producing oil or gas field. The permits to be on condition that the permittee within six months shall drill a well to a depth of at least 500 feet and within two years from date of permit to a depth of 2000 feet.

It further provided that the Secretary of the Interior, if he found the permittee unable with diligence to test the land in the time granted, might extend the permit for not exceeding two years; that upon establishing to the satisfaction of the Secretary that valuable deposits of oil or gas had been discovered, the permittee was entitled to a lease on one-fourth of the land for a period of twenty years at a royalty of 5% of the oil produced and a preference right to a lease

for the remainder of the land at a royalty of not less than 12½%; that prior to application for a lease the royalty should be 20% to the United States on oil produced under the permit.

The Act of January 11, 1922 (42 Stat. 356) authorized extension of time for drilling not to exceed three years.

The Act of April 5, 1926 (44 Stat. 236) authorized a further extension of two years.

The Act of March 9, 1928 (45 Stat. 252) authorized extension for two years.

The Act of January 23, 1930 (46 Stat. 56) authorized extension for three years.

The Act of June 30, 1932 (47 Stat. 445) authorized extension for an additional three years.

The Act of August 21, 1935 (49 Stat. 674) extended all permits to December 31, 1937, with authority to the Secretary to extend for one additional year but not beyond December 31, 1938.

The Act of August 26, 1937 (50 Stat. 842) provided that in certain cases where pooling agreements had been approved or drilling prosecuted the permits were extended to December 31, 1939.

The term of the leases to be issued to permittees under the 1920 Act was twenty years with the right of renewal for successive periods of ten years. (Secs. 14 and 17)

The 1935 Act provided that lands not within any known geological structure of a producing oil or gas field might be leased at a royalty not less than 12½% and for a period of five years and as long thereafter as oil is produced in paying quantities. Preference right to such lease was given to permittees to receive such lease.

The 1942 amendment provided for preference right to a lessee for issuance of a renewal lease.

From these statutes and amendments it is clear that there has been since 1920 no fundamental change in the nature of rights granted by the United States for the exploration and development by private persons of lands believed to contain oil or gas, and that the policy has consistently been to extend and renew the rights of persons who had acquired such rights.

Judicial discussion of the nature of these rights indicates no fundamental distinction other than in nomenclature between a "prospecting permit" and a "lease".

In Herigstad vs. Hardrock Oil Co., 52 P. 2d 171, 173; 101 Mont. 22, the Court said:

> "The 'prospecting permits' issued under authority of the Act of Congress (Feb. 25, 1920, Chapt. 85, Sec. 13, 41 Stat. 441, 30 USCA Sec. 221) constitute more than a license to the permittee, and, if exclusive possession for a definite period creates an interest in land, they have this effect, for such a permit grants, in writing, 'the exclusive right, for a period not exceeding two years, to prospect for oil or gas' upon a selected tract not exceeding 2560 acres, which time may be extended under certain conditions. (Sec. 224, 30 USCA P. 402) Discovery of oil or gas entitles the permittee to a lease on one-fourth of the land included in the permit upon a royalty of 5 per cent in amount of the value of production and to a preference right to a lease on the balance of the land on a 12½ per cent royalty. Section 223, 30 USCA P. 401. After production of oil or gas, the permittee is entitled to that produced, until application for the lease, on payment of 20 per cent of the gross value to the government. Sec. 244 30 USCA."
>
> "Under the Act and the authorities, the government 'prospecting permit' would seem to be practically equivalent to the ordinary lease of privately owned

land thought to contain oil and gas; the government merely adopts a different method of handling the matter."

*"This 'grant of a valuable right' does not differ from the grant contained in the ordinary oil and gas lease executed by the individual owner, and whatever the rule may be in other states, in this jurisdiction such a right is held to take 'the character of an interest or an estate in the land itself. It is an estate in the land although incorporeal'."*

The same court in Aronow v. Bishop, 86 P. 2d 644; 107 Mont. 317, in subjecting the later lease to royalties arising by assignment by a former permittee said:

"The permit is not extinguished by the granting of leases. It is the foundation for leases and when granted to the permittee or his assignee, they merely constitute in substance and effect, a continuation of rights granted by the permit but under different terms and conditions. Sec. 223, Title 30 USCA."

Petitioners' arguments based upon the claim that the 1935 Act and 1942 Act in some manner created a new type of lease which is of an entirely different order and character from the previous lease and prospecting permit are based upon hypertechnical interpretations inconceivable in a court of equity.

## V.

## PETITIONER PHILLIPS PETROLEUM COMPANY ACQUIRED AND DEVELOPED THIS PROPERTY WITH ACTUAL KNOWLEDGE OF THE ROYALTY INTERESTS OF RESPONDENTS.

We have quoted in our Statement of the case and elsewhere in this brief the letters of Phillips to H. W. Gray, agent of Levison and Gray, showing that Phillips was from the Land Office Records fully familiar with the entire history

of the permit, the assignment, McLaughlin's affidavit, and the lease issued in lieu of the permit. Phillips while negotiating with Levison and Gray aided in their obtaining the present lease in exchange for the lease issued to McLaughlin.

In view of this fact one can only conjecture as to the bearing this may have had on the final agreement between Phillips, as buyer, and Levison and Gray, as sellers, of the property. That Phillips knowingly assumed the risk that the Oldland Group would assert its claims to the royalty is clear.

Under such circumstances no amount of expenditure by Phillips could improve its equitable or legal position relative to the Oldland Group.

The two last cited cases of Herigstad v. Hardrock Oil Co., 52 P. 2d 171; 101 Mont. 22, and Aronow v. Bishop, 86 P. 2d 644; 107 Mont. 317, both resulted in holding the subsequent lessees liable for and subject to the royalties arising out of the permit since they had knowledge thereof. We do not burden this brief with quotations upon this well established rule.

That the venture was a successful one of great profit to Phillips is shown by its own production figures. It has not accepted the offer of Levison and Gray made by way of cross-claim (R. 104) asking reassignment of the lease to them in return for reimbursement by them to Phillips of all of its expenses of securing and improving the lease.

## VI.

## LIMITATION BY REGULATION OF OVERRIDING ROYALTIES TO 5% IF APPLICABLE OR VALID WOULD DESTROY THE LEVISON AND GRAY ROYALTY RESERVED IN 1945 RATHER THAN THE PRE-EXISTING OLDLAND GROUP ROYALTY RESERVED IN 1926.

Although the Court of Appeals determined the Oldland Group to be limited to a royalty of 4% of oil on all of the

acreage, Petitioners again cite in this Court a federal administrative regulation limiting overriding royalties to 5%. They contend that the Oldland Royalty added to the Levison and Gray royalty exceeds 5% as to the oil. They contend also that the 7½% royalty on gas decreed to the Oldland Group is in excess of that allowed by the administrative officials.

In answer to this argument we point out that the regulation in question was adopted long after the assignment by the Oldland Group to McLaughlin; that the Levison and Gray royalty is in dispute between them and Phillips upon their cross-claims yet to be tried in the District Court, and there Phillips has pleaded that if the Oldland royalty is established, Levison and Gray should receive none; that the Levison and Gray royalty reserved in 1945 would as junior in time and in right be first destroyed if the regulation is applicable or valid.

Finally we point out a few of the authorities for the rule that the Federal Courts will in decreeing the rights of parties not anticipate the action of administrative officials of the government, nor will the administrative officials assume the judicial role of determining the rights of private parties between themselves.

In Isaacs v. DeHon, 11 F. 2d 943, in an action upon a grubstake agreement for an interest in a government prospecting permit, the defense included alienage, failure to join the Secretary as a party and regulations regarding assignment. The Court found none of these a defense in a court of equity, saying:

> "If the Plaintiffs are aliens, appellant is in no position to take advantage of this circumstance. No one but the Sovereign has any right to complain of a trust in real estate in favor of an alien disqualified to hold title. Osterman v. Baldwin, 6 Wall. 116. * * * Such a

trust is valid until, at the instance of the government, the alienage is judicially established.

"Appellant is in no position to take advantage of this regulation. It may be that the Plaintiffs will lose the fruits of this litigation by the refusal of the Secretary to approve the assignment of interests in the permit. But appellant is nevertheless held in a court of equity to the obligations he has assumed in this grubstake contract."

"The courts will not interfere by mandate or injunction with his performance of his duties under the public land laws. * * * But the courts do have power to enforce contracts with reference to lands while title thereto is held by the government. Marquez v. Frisbie, 101 U. S. 473; Pappe v. Trout, 41 P. 397, 3 Okla. 260."

The regulation on transfers was again unsuccessfully raised in Witbeck v. Hardeman, 51 F. 2d 450, affirmed 52 Sup. Ct. 604, 286 U. S. 444, where the Court said:

"This restriction on transfer applies to voluntary transfers and will hardly be deemed applicable in case of death, bankruptcy or court decree. But the difficulty is met by the just assumption that the Secretary intends that leases and permits shall go to those whom the law entitles to them, and when a transfer is ordered to accomplish this his consent is to be implied, and may be compelled, if refused."

The ordinary procedure of the Department of the Interior when conflicting claims arise is to suspend action until the parties can litigate their rights between themselves in a court of competent jurisdiction, as is shown in the recent case of Blackner v. McDermott, 176 F. 2d 498, 500.

## VII.

## THE DECISION OF THE COURT OF APPEALS CONFORMS TO THE SETTLED RULES OF LAW AND EQUITY OF THE SUPREME COURT OF THE STATE OF COLORADO AND OF THE FEDERAL JUDICIARY.

While in the Petition herein it alleged that the decision of the Court of Appeals is contrary to the law of Colorado, we find no authority to that effect in the Brief in support thereof. This brief would become unduly long if we were to cite the Colorado authorities on the principles that a trust will not be divested by a conversion of the trust property by the trustee, that equity looks to the substance and not to the form, that a purchaser with knowledge takes subject to all equities and other general principles applicable to this case. Colorado has had little litigation over oil and gas property and we must go elsewhere for cases involving similar factual situations. That overriding royalties are interests in real estate in Colorado has been established by Pierce v. Marland Oil Co., 278 P. 804, 86 Colo. 59.

Where similar facts have existed we submit that there has been no authority other than supporting the decision of the Court of Appeals in this case.

In the same court was considered the case of Merritt Oil Corporation v. Young, 43 F. 2d 27, arising from a contract relative to oil placer claims made in 1915. After the 1920 Act became effective the claims could not be patented by the assignee as contemplated but by compromise with the government 800 acres were patented, 80 acres covered by a government lease and 1880 acres by prospecting permit. To an action to recover against the later holder an interest in the lease and permit the defense was asserted, as here, that a different kind of property than that contemplated by the contract had come into being and that the contract could not be enforced as to it. The Court answered this:

"A mere statement of the contention answers it. No interest is more zealously guarded by courts of equity than that of a cestui que trust. To permit a trustee to oust his cestui because the title to the trust estate fails in part, and to thus enrich himself, is unthinkable. This court has spoken, in no uncertain terms, on this subject, in Skinner v. Cromwell, 40 F. (2d) 241, 244. There an oil and gas lease held in trust, was conceived to be void and was canceled. A new lease, on the same property, was taken by the trustees in their own name, and approved by the Secretary of the Interior. The trustees claimed to own it personally, contending that the lease held by them as trustees no longer existed. This court held that 'their trust relation was such they could not deal with the subject in their private interest without first reporting the facts to their cestuis que trustent and giving them an opportunity to take or waive whatever benefits might be gotten out of the situation.' The court quoted with approval from 1 Perry on Trusts (5th Ed.) Chap. 196, as follows: 'If among the assets of the trust estate there are leases, the trustee cannot renew them in his own name; and if he renews them in his own name, he must hold them by a constructive trust for the same persons beneficially interested in the old lease.'

"The record clearly shows, and counsel for appellant concedes, that the appellant acquired the title to these properties by a 'compromise agreement made by the appellant and the government'; that is, by a surrender of its rights under the locations made in 1915. Mr. Justice Story laid down the governing principle when he said in Oliver et al v. Piatt, 3 How. 333, 401, 11 L. Ed. 622, that:

'And if the trustee has invested the trust property, or its proceeds, in any other property into which it can

be distinctly traced, the cestui que trust has his election either to follow the same into the new investment, or to hold the trustee personally liable for the breach of the trust. * * * The option, in such case, to take the new or the original fund is therefore, (as has been already suggested,) exclusively given to the cestui que trust, and is given to him for the wisest purposes and upon the soundest public policy. It is to aid in the maintenance of right and in the suppression of meditated wrong' . . .

"Appellant further contends that it is unfair to carry the trust, originally intended for located claims, over to an oil and gas lease and prospecting permit, with their attendant burdens. Appellant was not compelled to accept the lease and permit; it could have stood on its locations, and won or lost. When it accepted part in compromise of its claim for all, the rights of the cestui are not thereby divested; on the contrary, the trust attaches to the property received through such compromise. This contention of appellant is unfounded."

The same court more recently in Blackner v. McDermott, 176 F. 2d 498, had a similar question as to whether an operating agreement as to one lease extended to a subsequent lease from the government. The contentions and opinion of the court are stated by it:

"It may be that as between the United States and Blackner the second lease was a new one rather than an extension or renewal of the former lease. But that is not the test here. The test to be applied here is whether as between McDermott and Blackner the second lease was an extension or renewal of the first, within the intent and meaning of the original operating agreement. And in resolving that question, the language contained in the operating agreement, the rela-

tionship existing between the parties, and the background against which the agreement was drafted and entered into must be taken into consideration. Viewed in that manner, it is crystal clear that it was the mutual intention of the parties in entering into such agreement that their rights should continue throughout any lease which should issue as the outgrowth of their joint efforts then being exerted in connection with the preparation and filing of the original application, and otherwise. When all of the facts and circumstances are taken into consideration and given the weight to which they are entitled, it would unduly narrow the scope of the contract to construe it as having application only to the original lease, either during its primary period or during an extended or renewed period of it, but not to a subsequent lease to the same lessee which was the outgrowth of the joint efforts of the parties at the time of the filing of the application for the original lease and at the time of the issuance of such lease."

Similar questions arose in Dougherty v. California Kettleman Oil Royalties, Inc., 69 P. 2d 155, 9 Cal. 2d 58, and its related case General Petroleum Corp. v. Dougherty, 117 F. 2d 529. In the former case, after extended litigation, it was held that Dougherty was entitled, upon the strength of Ochsner's oral agreement made at the time of applying for a prospecting permit with the aid of Dougherty's knowledge of geology and procedure, to recover royalties accruing to defendant corporations, assignees of Ochsner. The Court said P. 167:

"This is an action to enforce a trust as to oil royalties. Such an action is clearly enforceable against an assignee who takes with notice of the outstanding royalty. Western Oil Co. v. Venago Oil Corp., 218 Cal. 733, 24 P. 2d 971, 88 ALR 1271. Even if the covenant on the part of Ochsner were a more personal

covenant it would be enforceable in equity against those who took with notice . . . . In the Present case the trial court found that both Universal and appellant took their respective assignments with full knowledge of Dougherty's outstanding claim . . . . Another complete answer to this point (the plea of the Statute of Frauds) is that under the facts of this case the moment the permit was issued a trust resulted in favor of Dougherty. (citing cases)"

In the General Petroleum case impossibiilty of performance was pleaded to Dougherty's claim to the royalty allowed him on the ground that in the meantime the land in question had been pooled with other land. This was answered by the Court:

"This appellant itself made it impossible to develop oil under the Permit lands in the manner contemplated under the Ochsner contract, and the royalties from that source were cut off, and there was substituted therefor the royalties allotted to appellant by Kenda based on the permit area in which appellees are entitled to their proportionate share. Where a trustee in violation of his trust has changed the trust property or its proceeds into other property the cestui que trust has his option, either to hold the substituted property liable to the original trust, or to hold the trustee liable for breach of trust. (citing cases) This right or option of the cestui que trust belongs exclusively to him and it is not in the power of the trustee to deprive him of it."

The well reasoned decisions in these and similar cases illustrate that in circumstances varying more from the situation contemplated by the parties originally than in the instant case the equities will be followed by the courts through the web however complex.

It is elementary that in oil and gas leases and related

transactions the primary consideration is the royalty to accrue to the lessor or assignor.

At all times by the very terms of the assignment by the Oldland Group to McLaughlin he had the privilege of terminating his obligations by reassigning and paying the small sum provided in case he had not developed the property. It would be unconscionable if Petitioners should now by means of hyper technical argument and by calling upon the founding fathers through the Fifth Amendment succeed in depriving the original pioneer placer claimants and their successors of the fruits of their labors and vision.

## CONCLUSION.

The Rector Group of Respondents pray that the Petition for Writ of Certiorari be denied.

Respectfully submitted,

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